

REDUCTION OF INDIVIDUAL INCOME TAXES

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE UNITED STATES SENATE

EIGHTIETH CONGRESS

SECOND SESSION

ON

H. R. 4790

AN ACT TO REDUCE INDIVIDUAL INCOME-TAX
PAYMENTS, AND FOR OTHER PURPOSES

MARCH 1, 2, 3, 5, 8, 9, AND 10, 1948

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REDUCTION OF INDIVIDUAL INCOME TAXES

MONDAY, MARCH 1, 1948

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

The committee met at 10 a. m., pursuant to call, in Room 312 of the Senate Office Building, Senator Eugene D. Millikin, chairman of the committee, presiding.

Present: Senators Millikin (chairman of the committee), Craft, Butler, Brewster, Bushfield, Martin, George, Barkley, Connally, Byrd, and Lucas.

Title CHAIRMAN. The committee will come to order.

This is a hearing on H. R. 4790, the tax-reduction bill.

(The bill is as follows:)

[H. R., 4700, 80th Cong., 2d sess.]

AN ACT To reduce individual income tax payments, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act, divided into titles and sections according to the following Table of Contents, may be cited as the "Revenue Act of 1948":

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- Sec. 102. Reduction in Supplement J tax.
- Sec. 103. Income of husband and wife.
- Sec. 104. Technical amendments.
- Sec. 105. Taxable years to which amendments applicable.

TITLE II—CREDITS AGAINST NET INCOME FOR NORMAL TAX AND SURTAX

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- Sec. 351. Transfers of community property in contemplation of death, etc.
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REDUCTION OF INDIVIDUAL INCOME TAXES

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- Sec. 401.** Individuals with adjusted gross incomes of less than \$5,000.

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- Sec. 501.** Percentage method.
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TITLE VI—FISCAL YEAR TAXPAYERS

- Sec. 601.** Fiscal year taxpayers.

TITLE I—INCOME TAX REDUCTION

SEC. 101. REDUCTION OF NORMAL TAX AND SURTAX.

Section 12 (c) of the Internal Revenue Code is hereby amended to read as follows:

"(c) REDUCTION OF TENTATIVE NORMAL TAX AND TENTATIVE SURTAX.—

- "(1)** The combined normal tax and surtax under section 11 and subsection (b) of this section shall be the aggregate of the tentative normal tax and tentative surtax, reduced as follows:

If the aggregate is:	The deduction shall be:
Not over \$200	33 $\frac{1}{2}$ % of the aggregate.
Over \$200 but not over \$279.17	\$67.
Over \$279.17 but not over \$840	24% of the aggregate.
Over \$840	\$201.60, plus 14 $\frac{1}{2}$ % of excess over \$840.

"(2) In no event shall the combined normal tax and surtax exceed 77 per centum of the net income."

SEC. 102. REDUCTION IN SUPPLEMENT T TAX.

For reduction in the tax under Supplement T of Chapter 1 of the Internal Revenue Code (tax table which may be used by taxpayer at his election if his adjusted gross income is less than \$5,000), see section 101.

SEC. 102. INCOME OF HUSBAND AND WIFE.

For tax in case of joint return of husband and wife (the so-called "splitting of Income"), see section 301.

SEC. 103. TECHNICAL AMENDMENTS.

(a) Section 11 of the Internal Revenue Code (relating to the normal tax on individuals) is hereby amended by striking out "by 5 per centum thereof" and inserting in lieu thereof "as provided in section 12 (c)".

(b) Section 12 (b) of the Internal Revenue Code (relating to the rate of surtax on individuals) is hereby amended by striking out "by 5 per centum thereof" and inserting in lieu thereof "as provided in subsection (c) of this section".

(c) Subsections (d), (e), (f), (g), and (h) of section 12 of the Internal Revenue Code are amended to read as follows:

"(e) COMPUTATION OF TAX WITHOUT REGARD TO CREDITS AGAINST TAX.—In the application of this section, the combined normal tax and surtax shall be computed without regard to the credits provided in sections 31, 32, and 35.

"(f) ASCERTAINMENT OF NORMAL TAX AND SURTAX SEPARATELY.—Whenever it is necessary to ascertain the normal tax and the surtax separately, the surtax shall be an amount which is the same proportion of the combined normal tax and surtax as the tentative surtax is of the aggregate of the tentative normal tax and tentative surtax; and the normal tax shall be the remainder of such combined normal tax and surtax.

"(g) CROSS REFERENCES.—

"(1) ALTERNATIVE TAX.—For alternative tax which may be elected if adjusted gross income is less than \$5,000, see Supplement T.

"(2) TAX IN CASE OF CAPITAL GAINS.—For rate and computation of alternative tax in lieu of normal tax and surtax in the case of capital gain from the sale or exchange of capital assets held for more than 6 months, see section 117 (e).

"(3) **TAX ON PERSONAL HOLDING COMPANIES.**—For surtax on personal holding companies, see section 500.

"(4) **AVOIDANCE OF SURTAXES BY INCORPORATION.**—For surtax on corporations which accumulate surplus to avoid surtax on shareholders, see section 102.

"(5) **SALM OF OIL OR GAS PROPERTIES.**—For limitation of surtax attributable to the sale of oil or gas properties, see section 105."

SEC. 105. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

TITLE II—CREDITS AGAINST NET INCOME FOR NORMAL TAX AND SURTAX

SEC. 201. ADDITIONAL CREDITS AGAINST NET INCOME FOR NORMAL TAX AND SURTAX.

Paragraphs (1) and (2) of section 25 (b) of the Internal Revenue Code are hereby amended to read as follows:

"(a) **CREDITS.**—There shall be allowed for the purposes of both the normal tax and the surtax, the following credits against net income:

"(A) An exemption of \$600 for the taxpayer; and an additional exemption of \$600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse, for the calendar year in which the taxable year begins, has no gross income and is not the dependent of another taxpayer;

"(B) (1) An additional exemption of \$600 for the taxpayer if he has attained the age of 65 before the close of the taxable year; and

"(1) An additional exemption of \$600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse has attained the age of 65 before the close of such taxable year, and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer;

"(C) (1) An additional exemption of \$600 for the taxpayer if he is blind at the close of his taxable year; and

"(1) An additional exemption of \$600 for the spouse of the taxpayer if a separate return is made by the taxpayer, and if the spouse is blind and, for the calendar year in which the taxable year of the taxpayer begins, has no gross income and is not the dependent of another taxpayer. For the purposes of this clause the determination of whether the spouse is blind shall be made as of the close of the taxable year of the taxpayer, unless the spouse dies during such taxable year, in which case such determination shall be made as of the time of such death.

"(1) For the purposes of this subparagraph, an individual is blind only if either: his central visual acuity does not exceed 20/200 in the better eye with correcting lenses, or his visual acuity is greater than 20/200 but is accompanied by a limitation in the field of vision such that the widest diameter of the visual field subtends an angle no greater than 20 degrees.

"(D) An exemption of \$600 for each dependent whose gross income for the calendar year in which the taxable year of the taxpayer begins is less than \$500, except that the exemption shall not be allowed in respect of a dependent who has made a joint return with his spouse under section 51 for the taxable year beginning in such calendar year.

"(2) **DETERMINATION OF STATUS.**—For the purposes of this subsection—

"(A) the determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and

"(B) an individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married."

SEC. 202. TECHNICAL AMENDMENTS.

(a) **DECLARATION OF ESTIMATED TAX.**—Section 58 (a) of the Internal Revenue Code (relating to requirement of declaration of estimated tax) is hereby amended to read as follows:

"(a) **REQUIREMENT OF DECLARATION.**—Every individual (other than an estate or trust and other than a nonresident alien with respect to whose wages, as

defined in section 1021 (a), withholding under Subchapter D or Chapter 9 is not made applicable) shall, at the time prescribed in subsection (d), make a declaration of his estimated tax for the taxable year if—

"(1) his gross income from wages (as defined in section 1021) can reasonably be expected to exceed the sum of \$4,500 plus \$600 with respect to each exemption provided in section 25 (b) ; or

"(2) his gross income from sources other than wages (as defined in section 1021) can reasonably be expected to exceed \$100 for the taxable year and his gross income to be \$600 or more."

(b) **WITHHOLDING EXEMPTIONS.**—

(1) **IN GENERAL.**—Section 1022 (h) (1) of the Internal Revenue Code is hereby amended to read as follows:

"(1) **IN GENERAL.**—An employee receiving wages shall on any day be entitled to the following withholding exemptions:

"(A) An exemption for himself.

"(B) One additional exemption for himself if, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 25 (b) (1) (B) (1) (relating to old age) for the taxable year under Chapter 1 in respect of which amounts deducted and withheld under this subchapter in the calendar year in which such day falls are allowed as a credit.

"(C) One additional exemption for himself if, on the basis of facts existing at the beginning of such a day, there may reasonably be expected to be allowable an exemption under section 25 (b) (1) (C) (1) (relating to the blind) for time taxable year under Chapter 1 in respect of which amounts deducted and withheld under this subchapter in the calendar year in which such day falls are allowed as a credit.

"(D) If the employee is married, any exemption to which his spouse is entitled, or would be entitled if such spouse were an employee receiving wages, under subparagraph (A), (B), or (C), but only if such spouse does not have in effect a withholding exemption certificate claiming such exemption.

"(E) An exemption for each individual with respect to whom, on the basis of facts existing at the beginning of such day, there may reasonably be expected to be allowable an exemption under section 25 (b) (1) (D) for time taxable year under Chapter 1 in respect of which amounts deducted and withheld under this subchapter in the calendar year in which such day falls are allowed as a credit."

(2) **STATUS DETERMINATION DATE.**—In the case of an individual entitled to an additional withholding exemption under section 1022 (h) (1) of the Internal Revenue Code by reason of the amendment made thereto by paragraph (1) of this subsection, the term "status determination date" as used in section 1022 (h) (3) (B) of such Code includes also the ninetieth day after the date of the enactment of this Act.

(c) **REQUIREMENT OF RETURNS.**—

(1) **INDIVIDUAL RETURNS.**—Section 51 (a) of the Internal Revenue Code (relating to the requirement of individual returns) is hereby amended by striking out "\$500" and inserting in lieu thereof "\$600".

(2) **FIDUCIARY RETURNS.**—Section 142 (a) of such Code (relating to the requirement of fiduciary returns) is hereby amended by striking out "\$500" wherever appearing therein and inserting in lieu thereof "\$600".

(3) **INFORMATION RETURNS.**—Section 147 (a) of such Code (relating to returns of information) is hereby amended by striking out "\$500" wherever appearing therein and inserting in lieu thereof "\$600".

(d) **CREDIT OF ESTATE AGAINST NET INCOME.**—Section 103 (a) (1) of such Code (relating to credits against net income of an estate) is hereby amended by striking out "\$500" and inserting in lieu thereof "\$600".

(e) **REPEAL OF DEDUCTION FOR BLIND INDIVIDUALS.**—Effective with respect to taxable years beginning after December 31, 1947, section 23 (y) of such Code (relating to special deduction for blind individuals) is repealed.

SEC. 203. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

The amendments made by this title shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

REDUCTION OF INDIVIDUAL INCOME TAXES

TITLE III—HUSBAND AND WIFE

PART I—INCOME TAX

SEC. 301. SPLITTING OF INCOME.

Section 12 of the Internal Revenue Code (relating to surtax of individuals) is hereby amended by adding after subsection (c) of such section the following new subsection:

"(d) TAX IN CASE OF JOINT RETURN.—In the case of a joint return of husband and wife under section 51 (b), the combined normal tax and surtax under section 11 and subsection (b) of this section shall be twice the combined normal tax and surtax that would be determined if the net income and the applicable credits against net income provided by section 25 were reduced by one-half."

SEC. 302. STANDARD DEDUCTION.

(a) INCREASE OF STANDARD DEDUCTION IN CASE OF JOINT RETURN OR RETURN BY UNMARRIED PERSON.—Section 23 (n) (A) (A) of the Internal Revenue Code (relating to the standard deduction) is hereby amended to read as follows:

"(A) Adjusted Gross Income \$5,000 or More.—If his adjusted gross income is \$5,000 or more, the standard deduction shall be \$1,000 or an amount equal to 10 per centum of the adjusted gross income, whichever is the lesser, except that in the case of a separate return by a married individual, the standard deduction shall be \$500."

(b) ELECTION BY HUSBAND AND WIFE.—Section 23 (aa) (4) of such Code is hereby amended to read as follows:

"(4) HUSBAND AND WIFE.—In the case of husband and wife, the standard deduction shall not be allowed to either if the net income of one of the spouses is determined without regard to the standard deduction."

(c) DETERMINATION OF STATUS.—Section 23 (aa) of such Code is hereby amended by adding at the end thereof the following new paragraph:

"(C) DETERMINATION OF STATUS.—For the purpose of this subsection—

"(A) the determination of whether an individual is married shall be made as of the close of his taxable year, unless his spouse dies during his taxable year, in which case such determination shall be made as of the time of such death; and

"(B) in individual legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married."

SEC. 303. JOINT RETURNS OF HUSBAND AND WIFE.

Section 51 (b) of the Internal Revenue Code (relating to joint returns) is hereby amended to read as follows:

"(b) HUSBAND AND WIFE.—

"(1) IN GENERAL.—A husband and wife may make a single return jointly. Such a return may be made even though one of the spouses has neither gross income nor deductions. If a joint return is made the tax shall be computed on the aggregate income and the liability with respect to the tax shall be joint and several.

"(2) NONRESIDENT ALIEN.—No joint return may be made if either the husband or wife at any time during the taxable year is a nonresident alien.

"(3) DIFFERENT TAXABLE YEARS.—No joint return shall be made if the husband and wife have different taxable years; except that if such taxable years begin on the same day and end on different days because of the death of either or of both, then the joint return may be made with respect to the taxable year of each. The above exception shall not apply if the surviving spouse remarries before the close of his taxable year, nor if the taxable year of either spouse is a fractional part of a year under section 47 (a).

"(4) JOINT RETURN AFTER DEATH.—In the case of the death of one spouse or both spouses the joint return with respect to the decedent may be made only by his executor or administrator; except that in the case of the death of one spouse the joint return may be made by the surviving spouse with respect to both himself and the decedent if (A) no return for the taxable year has been made by the decedent, (B) no executor or administrator has been appointed, and (C) no executor or administrator is appointed before the last day prescribed by law for filing the return of the surviving spouse. If an executor or administrator of the decedent is appointed after the making of the joint return by the surviving spouse, the executor or administrator may disaffirm such joint return by making, within one year after the last day

prescribed by law for filing the return of the surviving spouse, a separate return for the taxable years of the decedent with respect to which the joint return was made, in which case the return made by the survivor shall constitute his separate return.

(A) the status as husband and wife of two individuals having taxable years beginning on the same day shall be determined—

(i) if both have the same taxable year—as of the close of such year; and

(ii) if one dies before the close of the taxable year of the other—as of the time of such death; and

(B) an individual who is legally separated from his spouse under a decree of divorce or of separate maintenance shall not be considered as married.

(G) TAX IN CASE OF JOINT RETURN.—For determination of combined normal tax and surtax under section 11 and section 12 (b) in case of joint return under this subsection, see section 12 (d). For tax in case of joint return of husband and wife electing to pay the tax under Supplement T, see section 400."

SEC. 304. DEDUCTION FOR MEDICAL EXPENSES.

Section 23 (x) of the Internal Revenue Code (relating to deduction of medical, etc., expenses) is hereby amended by striking out the second and third sentences thereof and inserting in lieu thereof the following: "The deduction shall not be in excess of \$1,250 multiplied by the number of exemptions allowed under section 25 (b) for the taxable year (exclusive of exemptions allowed under section 25 (b) (1) (B) or (C)), with a maximum deduction of \$2,500, except that the maximum deduction shall be \$5,000 in the case of a joint return of husband and wife under section 51 (b)."

SEC. 305. TAXABLE YEARS TO WHICH AMENDMENTS APPLICABLE.

The amendments made by sections 301, 302, 303, and 304 shall be applicable with respect to taxable years beginning after December 31, 1947. The amendment made by section 303 shall also be applicable to taxable years of both husband and wife beginning on the same day in 1947 if at least one of such taxable years ends in 1948. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

PART II—ESTATE TAX

Subpart _____ of 1942 _____ Property Amendments

SEC. 351. TRANSFERS OF COMMUNITY PROPERTY IN CONTEMPLATION OF DEATH, ETC.

Effective with respect to estates of decedents dying after the date of the enactment of this Act, section 811 (d) (5), of the Internal Revenue Code (relating to transfers of community property in contemplation of death, etc.) is hereby repealed.

SEC. 352. JOINT AND COMMUNITY INTERESTS.

(a) Effective with respect to estates of decedents dying after the date of the enactment of this Act, section 811 (e) (2), of the Internal Revenue Code (relating to inclusion of community property in gross estate of decedent) is hereby repealed.

(b) Such section 811 (e) is further amended—

(1) by striking out of the heading of such subsection the words "AND COMMUNITY"; and

(2) by striking out of paragraph (1) the following: "(1) JOINT INTERESTS.—".

SEC. 353. PROCEEDS OF LIFE INSURANCE.

Effective with respect to estates of decedents dying after the date of the enactment of this Act, section 811 (g) (4) of the Internal Revenue Code (relating to life insurance in the case of decedents in community-property States) is hereby repealed.

Subpart 2—Marital Deduction for Bequests, Etc., to Spouse

SEC. 361. MARITAL DEDUCTION.

(a) Section 812 of the Internal Revenue Code (relating to deductions in computing net estate in the case of a citizen or resident of the United States) is hereby

"(e) REQUESTS, ETC., TO SURVIVING SPOUSE.**"(1) ALLOWANCE OF MARITAL DEDUCTION.—**

(A) In General.—An amount equal to the value of any interest in property passing from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

"(B) Life Estate or Other Terminable Interests.—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed with respect to such interest—

"(i) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse; and

"(ii) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

"(C) Interest of Spouse Conditioned on Survival For Limited Period.—For the purposes of subparagraph (B) an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fall upon the death of such spouse if—

"(i) such death will cause a termination or failure of such interest only if it occurs within a period (not exceeding six months) after the decedent's death; and

"(ii) such spouse in fact does not die before time expiration of such period.

"(D) Interest Of Surviving Spouse Reduced By Reason Of Estate, Etc., Taxes.—In determining for the purposes of subparagraph (A) the value of any interest in property passing to the surviving spouse there shall be taken into account the effect which a tax imposed by this chapter, or any estate, succession, legacy, or inheritance tax, has upon the net value to the surviving spouse of such interest.

"(E) Trust With Power Of Appointment In Surviving Spouse.—In the case of an interest in property passing from the decedent to a trust, if the trust will terminate upon the death of the surviving spouse of the decedent, and if under the terms of the trust such spouse is entitled for her life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with the power to appoint by will the entire corpus to her estate, and with no power in herself or any other person to appoint or invade any part of the corpus during her life—

"(i) the interest so passing shall, for the purposes of subparagraph (A), be considered as passing to the surviving spouse, and

"(ii) no part of the interest so passing shall, for the purposes of subparagraph (B) (1), be considered as passing to any person other than the surviving spouse.

This subparagraph shall be applicable only if, under the terms of the trust, such power to appoint by will is exercisable in all events.

"(F) Limitation On Aggregate Of Deductions.—The aggregate amount of the deductions allowed under this paragraph (computed without regard to this subparagraph) shall not exceed 50 per centum of the value of the adjusted gross estate, as defined in paragraph (2).

"(2) COMPUTATION OF ADJUSTED GROSS ESTATE.—

(A) General Rule.—Except as provided in subparagraph (B) of this paragraph the adjusted gross estate shall, for the purposes of paragraph (1) (F), be computed by subtracting from the entire value of the gross estate the aggregate amount of the deductions allowed by subsection (b) of this section.

"(B) Special Rule In Cases Involving Community Property.—If the decedent and his surviving spouse at any time held property as community property under the law of any State, Territory, or possession of the United States, or of any foreign country, then the adjusted gross estate shall, for the purposes of paragraph (1) (F), be determined by subtracting from the entire value of the gross estate the sum of:

"(1) the value of property which is at the time of the death of the decedent held as such community property; and

REDUCTION OF INDIVIDUAL INCOME TAXES

"(ii) the value of property transferred by the decedent during his life, if at the time of such transfer the property was held as such community property; and

"(iii) the amount receivable as insurance under policies upon the life of the decedent to the extent purchased with premiums or other consideration paid out of property held as such community property; and

"(iv) an amount which bears the same ratio to the aggregate of the deductions allowed under subsection (b) of this section which the value of the property included in the gross estate, diminished by the amount subtracted under clauses (i), (ii), and (iii) of this subparagraph, bears to the entire value of the gross estate.

For the purposes of clauses (i), (ii), and (iii), property shall be considered as 'held as such community property' if it was at any time acquired by the decedent (by one exchange or by a series of exchanges) in exchange for his interest in property held as such community property. The amount to be subtracted under clause (i), (ii), or (iii) shall not exceed the value of the interest in the property described therein which is included in determining the value of the gross estate.

"(B) **DEFINITION.**—For the purpose of this subsection an interest in property shall be considered as passing from the decedent to any person if and only if—

"(A) such interest is bequeathed or devised to such person by the decedent; or

"(B) such interest is inherited by such person from the decedent; or

"(C) such interest is the dower or curtesy interest (or statutory interest in lieu thereof) of such person as surviving spouse of the decedent; or

"(D) such interest has been transferred to such person by the decedent at any time; or

"(E) such interest was, at the time of the decedent's death, held by such person and the decedent (or by them and any other person) in joint ownership with right of survivorship; or

"(F) the decedent had a power (either alone or in conjunction with any person) to appoint such interest and if he appoints or has appointed such interest to such person, or if such person takes such interest in default upon the release or nonexercise of such power; or

"(G) such interest consists of proceeds of insurance upon the life of the decedent."

(b) The amendment made by subsection (a) of this section shall be applicable only with respect to estates of decedents dying after the date of the enactment of this Act.

SEC. 362. PROPERTY PREVIOUSLY TAXED.

(a) Section 812 (c) of the Internal Revenue Code (relating to the deduction for property previously taxed) is hereby amended by adding after the first paragraph a new paragraph to read as follows:

"The following property shall not, for the purposes of this subsection, be considered as property with respect to which a deduction may be allowed: (A) property received from a prior decedent who died after the date of the enactment of the Revenue Act of 1948 and was at the time of such death the decedent's spouse, (B) property received by gift after such date from a donor who at the time of the gift was the decedent's spouse, and (C) property acquired in exchange for property described in clause (A) or (B)."

(b) Section 812 (c) is further amended by striking out "subsections (a) and (d)" and inserting in lieu thereof "subsections (a), (d), and (e)".

PART III—GIFT TAX

SEC. 371. GIFTS OF COMMUNITY PROPERTY.

Section 10 (d) of the Internal Revenue Code (relating to gifts of property held as community property) is amended by adding at the end thereof a new sentence to read as follows: "This subsection shall be applicable only to gifts made after the calendar year 1942 and on or before the date of the enactment of the Revenue Act of 1948."

SEC. 372. MARITAL DEDUCTION.

Section 1004 (a) of the Internal Revenue Code (relating to deductions in computing net gifts in the case of a citizen or resident of the United States) is hereby amended by adding at the end thereof a new paragraph to read as follows:

"(3) GIFT TO SPOUSE.—

"(A) In General.—Where the donor transfers during the calendar year (and after the date of the enactment of the Revenue Act of 1948) by gift an interest in property to a donee who at the time of the gift is the donor's spouse—an amount with respect to such interest equal to one-half of its value.

"(B) Life Estate or Other Terminable Interest.—Where, upon the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur, such interest transferred to the spouse will terminate or fall, no deduction shall be allowed with respect to such interest—

(1) If the donor retains in himself, or transfers or has transferred (for less than an adequate and full consideration in money or money's worth) to any person other than such donee's spouse, an interest in such property, and if by reason of such retention or transfer the donor (or his heir or assigns) or such person (or his heir or assigns) may see or enjoy any part of such property after such termination or failure of an interest transferred to the donee spouse; or

(2) If the donor immediately after the transfer to the donee spouse or appoints an interest in such property which he can exercise (either alone or in conjunction with any person) in such manner that the appointee may possess or enjoy any part of such property after such termination or failure of the interest transferred to the donee spouse. For the purposes of this clause and all such interests having immediately after the transfer to the donee spouse such power to appoint even though such power cannot be exercised until after the lapse of time, upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur.

Exercise of such power shall be considered as a transfer to the donee spouse, and shall be considered as a transfer to the donee spouse, even though not otherwise so a transfer, for the purposes of clause (1), if this subparagraph shall be considered as a transfer to him.

"(C) Joint Interest.—If the interest is transferred to the donee spouse as sole joint tenant with the donor or as joint tenant by the entirety, the interest of the donor in the property which exists solely by reason of the possibility that the donor may survive the donee spouse, or that there may occur a severance of the tenancy, shall not be considered for the purposes of subparagraph (1) as an interest retained by the donor in himself.

"(D) Trust With Power Of Appointment In Donee Spouse.—Where the donor transfers in trust an interest in property, and the trust will terminate upon the death of his spouse, and under the terms of the trust his spouse is entitled for her life to all the income from the corpus of the trust, payable annually or at more frequent intervals, with the power to appoint by will the entire corpus to her estate, and with no power in herself or any other person to appoint or invade any part of the corpus during her life—

(1) the interest so transferred in trust shall, for the purposes of subparagraph (A), be considered as transferred to the donee spouse, and

(2) no part of the interest so transferred in trust shall, for the purposes of subparagraph (B) (1), be considered as retained in the donor or transferred to any person other than the donee spouse. This subparagraph shall be applicable only if, under the terms of the trust, such power to appoint by will is exercisable in all events.

"(E) Community Property.—A deduction otherwise allowable under this paragraph shall be allowed only to the extent the transfer can be shown to represent a gift of property which does not fall within either of the two following classes:

"(I) Property which is, at the time of the gift, held as community property under the law of any State, Territory, or possession of the United States, or of any foreign country; or

"(II) Property which, although not so held, was at any time acquired by the donor (by one exchange or by a series of exchanges) in exchange for his interest in property held by him and the donee spouse as community property."

SEC. 373. TECHNICAL AMENDMENTS.

Section 1004 (c) of the Internal Revenue Code is hereby amended to read as follows:

"(c) EXTENT OF DEDUCTIONS.—The deductions provided in subsection (a) (2) or (3) or in subsection (b), shall be allowed only to the extent that the gifts therein specified are included in the amount of gifts against which such deductions are applied."

SEC. 374. GIFT OF HUSBAND OR WIFE TO THIRD PARTY.

Section 1000 of the Internal Revenue Code (relating to imposition of gift tax) is hereby amended by adding at the end thereof a new subsection to read as follows:

"(f) GIFT OF HUSBAND OR WIFE TO THIRD PARTY.—

"(1) CONSIDERED AS MADE ONE-HALF BY EACH.—

(A) In General.—A gift made after the date of the enactment of the Revenue Act of 1918 by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse, but only if at the time of the gift each spouse is a citizen or resident of the United States. For the purposes of this subsection an individual shall be considered as the spouse of another individual only if he is married to such individual at the time of the gift and does not remarry during the remainder of the calendar year.

(B) Consent of Both Spouses.—Subparagraph (A) shall be applicable only if both spouses have signified (in accordance with the regulation provided for in paragraph (2)) their consent to the application of subparagraph (A) in the case of all such gifts made during the calendar year by either while married to the other.

(2) TIME AND MANNER OF SIGNIFYING CONSENT.—A consent under this subsection shall be signified at such time and in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary. The right to consent, and the right to revoke a consent previously signified, with respect to a calendar year, shall not exist on any day if a return for such year of one spouse (required otherwise than by reason of the application of paragraph (1)) filed on such day would be a return not timely filed.

(3) JOINT AND SEVERAL LIABILITY FOR TAX.—If the consent required by paragraph (1) (B) is signified with respect to a gift made in any calendar year the liability with respect to the entire tax imposed by this chapter of each spouse for such year shall be joint and several."

TITLE IV-ADJUSTED GROSS INCOME OF LESS THAN \$5,000

SEC. 401. INDIVIDUALS WITH ADJUSTED GROSS INCOMES OF LESS THAN \$5,000.

(a) IN GENERAL.—Section 400 of the Internal Revenue Code (relating to optional tax on individuals with adjusted gross incomes of less than \$5,000) is hereby amended to read as follows:

"SEC. 400. IMPOSITION OF TAX.

"In lieu of the taxes imposed by sections 11 and 12, there shall be levied, collected, and paid for each taxable year upon the net income of each individual whose adjusted gross income for such year is less than \$5,000, and who has elected to pay the tax imposed by this supplement for such year, a tax as follows:

"Tax other than **in case** of joint return of husband and wife under section 51

"Income" gross		And the number of	"Income" gross		And the number of	
At least	But less than	exemptions per person	At least	But less than	at	The tax rate
		2 3 more				3 4 5 6 7 8 or more
		The — small be-				
	\$075		\$2.325	\$2.35		
075	700		2.350	2.375	35	
700	725		2.375	2.400		
725			2.400	2.425		
750	775		2.425	2.450	50	
775	800		2.450	2.475		
800	825		2.475	2.500	0	
825	850		2.500	2.525		
850	875		2.525	2.550	50	
875	900		2.550	2.575		
900	925		2.575	2.600	0	
925	950		2.600	2.625	50	
950	975		2.625	2.650	0	
975	1,000		2.650	2.675	0	
1,000	1,025		2.675	2.700		
1,025	1,050		2.700	2.725		
1,050	1,075		2.725	2.750		
1,075	1,100		2.750	2.775	50	
1,100	1,125		2.775	2.800	0	
1,125			2.800	2.825	50	
1,125	1,150		2.825	2.850		
1,150	1,175		2.850	2.875		
1,175	1,200		2.875	2.900	0	
1,200	1,225		2.900	2.925		
1,225	1,250		2.925	2.950	0	
1,250	1,275		2.950	2.975		
1,275	1,300		2.975	3.000		
1,300	1,325		3.000	3.025		
1,325	1,350		3.025	3.050		
1,350	1,375		3.050	3.100		
1,375	1,400		3.100	3.150		
1,400	1,425		3.150	3.200	D	
1,425	1,450		3.200	3.250		
1,450	1,475		3.250	3.300	0	
1,475	1,500		3.300	3.350		
1,500	1,525		3.350	3.400		
1,525	1,550		3.400	3.450	0	
1,550	1,575		3.450	3.500		
1,575	1,600		3.500	3.550		
1,600	1,625		3.550	3.600		
1,625	1,650		3.600	3.650		
1,650	1,675		3.650	3.700		
1,675	1,700		3.700	3.750		
1,700	1,725		3.750	3.800		
1,725			3.800	3.850	0	
1,750	1,775		3.850	3.900	4	
1,775	1,800		3.900	3.950		
1,800	1,825		3.950	4.000	0	
1,825			4.000	4.050		
1,850	1,875		4.050	4.100		
1,875	1,900		4.100	4.150		
1,900	1,925		4.150	4.200	0	
1,925	1,950		4.200	4.250		
1,950	1,975		4.250	4.300	0	
1,975	2,000		4.300	4.350		
2,000	2,025		4.350	4.400	0	
2,025			4.400	4.450		
2,050	2,075		4.450	4.500		
2,075	2,100		4.500	4.550		
2,100	2,125		4.550	4.600		
2,125	2,150		4.600	4.650		
2,150	2,175		4.650	4.700	0	
2,175	2,200		4.700	4.750	0	
2,200	2,225		4.750	4.800		
2,225	2,250		4.800	4.850		
2,250	2,275		4.850	4.900		
2,275	2,300		4.900	4.950		
2,300	2,325		4.950	5.000		

"Tax in case of joint return of husband and wife under section 51

If adjusted gross income is—			And the number of exemptions is—	If adjusted gross income is—			And the number of exemptions is—						
At least	But less than		4 or more	At least	But less than		2	3	4	5	6	7	8 or more
The tax shall be—				The tax shall be—									
\$0	\$1,350	\$0	\$0	\$2,675	\$2,700	\$162	\$822	\$2	\$0	\$0	\$0	\$0	\$0
1,350	1,375	3	0	2,700	2,725	165	840	5	0	0	0	0	0
1,375	1,400	6	0	2,725	2,750	168	860	8	0	0	0	0	0
1,400	1,425	9	0	2,750	2,775	171	880	11	0	0	0	0	0
1,425	1,450	12	0	2,775	2,800	174	900	14	0	0	0	0	0
1,450	1,475	15	0	2,800	2,825	177	920	17	0	0	0	0	0
1,475	1,500	18	0	2,825	2,850	180	940	20	0	0	0	0	0
1,500	1,525	21	0	2,850	2,875	183	960	23	0	0	0	0	0
1,525	1,550	24	0	2,875	2,900	186	980	26	0	0	0	0	0
1,550	1,575	27	0	2,900	2,925	189	1000	29	0	0	0	0	0
1,575	1,600	30	0	2,925	2,950	192	1020	32	0	0	0	0	0
1,600	1,625	33	0	2,950	2,975	195	1040	35	0	0	0	0	0
1,625	1,650	36	0	2,975	3,000	198	1060	38	0	0	0	0	0
1,650	1,675	39	0	3,000	3,050	202	1080	41	0	0	0	0	0
1,675	1,700	42	0	3,050	3,100	208	1100	44	0	0	0	0	0
1,700	1,725	45	0	3,100	3,150	214	1120	47	0	0	0	0	0
1,725	1,750	48	0	3,150	3,200	220	1140	50	0	0	0	0	0
1,750	1,775	51	0	3,200	3,250	226	1160	53	0	0	0	0	0
1,775	1,800	54	0	3,250	3,300	232	1180	56	0	0	0	0	0
1,800	1,825	57	0	3,300	3,350	238	1200	59	0	0	0	0	0
1,825	1,850	60	0	3,350	3,400	244	1220	62	0	0	0	0	0
1,850	1,875	63	0	3,400	3,450	250	1240	65	0	0	0	0	0
1,875	1,900	66	0	3,450	3,500	256	1260	68	0	0	0	0	0
1,900	1,925	69	0	3,500	3,550	262	1280	71	0	0	0	0	0
1,925	1,950	72	0	3,550	3,600	270	1300	74	0	0	0	0	0
1,950	1,975	75	0	3,600	3,650	279	1320	77	0	0	0	0	0
1,975	2,000	78	0	3,650	3,700	288	1340	80	0	0	0	0	0
2,000	2,025	81	0	3,700	3,750	297	1360	83	0	0	0	0	0
2,025	2,050	84	4	3,750	3,800	306	1380	86	0	0	0	0	0
2,050	2,075	87	7	3,800	3,850	315	1400	89	0	0	0	0	0
2,075	2,100	90	10	3,850	3,900	324	1420	92	0	0	0	0	0
2,100	2,125	93	13	3,900	3,950	333	1440	95	0	0	0	0	0
2,125	2,150	96	16	3,950	4,000	342	1460	98	0	0	0	0	0
2,150	2,175	99	19	4,000	4,050	351	1480	101	0	0	0	0	0
2,175	2,200	102	22	4,050	4,100	360	1500	104	0	0	0	0	0
2,200	2,225	105	25	4,100	4,150	369	1520	107	0	0	0	0	0
2,225	2,250	108	28	4,150	4,200	378	1540	110	0	0	0	0	0
2,250	2,275	111	31	4,200	4,250	387	1560	113	0	0	0	0	0
2,275	2,300	114	34	4,250	4,300	396	1580	116	0	0	0	0	0
2,300	2,325	117	37	4,300	4,350	405	1600	119	0	0	0	0	0
2,325	2,350	120	40	4,350	4,400	414	1620	122	0	0	0	0	0
2,350	2,375	123	43	4,400	4,450	423	1640	125	0	0	0	0	0
2,375	2,400	126	46	4,450	4,500	430	1660	128	0	0	0	0	0
2,400	2,425	129	4	4,500	4,550	437	1680	131	0	0	0	0	0
	2,450	132	62	4,550	4,600	443	1700	134	0	0	0	0	0
2,450	2,475	135	65	4,600	4,650	450	1720	137	0	0	0	0	0
2,475	2,500	138	68	4,650	4,700	457	1740	140	0	0	0	0	0
2,500	2,525	141	61	4,700	4,750	464	1760	143	0	0	0	0	0
2,525	2,550	144	64	4,750	4,800	471	1780	146	0	0	0	0	0
2,550	2,575	147	67	4,800	4,850	478	1800	149	0	0	0	0	0
2,575	2,600	150	70	4,850	4,900	485	1820	152	0	0	0	0	0
2,600	2,625	153	73	4,900	4,950	491	1840	155	0	0	0	0	0
2,625	2,650	156	76	4,950	5,000	498	1860	158	0	0	0	0	0
2,650	2,675	159	79				1880	161	0	0	0	0	0

(b) TAXABLE YEARS TO WHICH APPLICABLE.—The amendment made by this section shall be applicable with respect to taxable years beginning after December 31, 1947. For treatment of taxable years beginning in 1947 and ending in 1948, see section 601.

TITLE V-REDUCTION IN WITHHOLDING OF TAX AT SOURCE ON WAGES

SEC. 501. PERCENTAGE METHOD.

Section 1022 (a) and section 1022 (b), (1) of the Internal Revenue Code (relating to percentage method of withholding) are hereby amended to read as follows:
 "(a) REQUIREMENT OF WITHHOLDING.—Every employer making payments of wages shall deduct and withhold upon such wages a tax equal to the sum of the following:

REDUCTION OF INDIVIDUAL INCOME TAXES

"If the pay-roll period with respect to an employee is weekly-

And the wages are— And the number of withholding exemptions claimed is—

At least But not less than

0	1	2	3	4	5	6	7	8	9	10 or more
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 The amount of tax to be withheld shall be—

Wages	0	1	2	3	4	5	6	7	8	9	10 or more
120.....	\$3.60	\$1.60	\$0.10								
27.....	3.70	1.80	.20								
.....	3.80	1.0	.30								
30.....	4.00	2.00	.70								
32.....	4.20	2.10	.60								
33.....	4.30	2.20	.70								
34.....	4.40	2.40	.00								
35.....	4.60	2.60	.00								
36.....	4.70	2.0	1.10								
37.....	4.0	2.60	1.20								
38.....	5.00	3.00	1.30								
39.....	5.10	3.20	1.40								
40.....	5.30	3.30	1.50								
41.....	5.40	3.0	1.70								
42.....	5.00	3.70	1.80								
43.....	5.70	3.00	1.0								
44.....	5.80	4.10		.60							
45.....	6.00	4.20	2.10		.60						
46.....	6.10	4.30	2.30		.70						
47.....	6.20	4.50	2.40		.70						
48.....	6.40	4.60	2.0		1.00						
49.....	6.60	4.70	2.60		1.10						
50.....	6.60	4.0	2.0		1.20						
51.....	6.80	5.00	3.00		1.30						
52.....	6.90	5.20	3.20		1.40						
53.....	7.00	5.30	3.40								
54.....	7.20	4.40	3.0		.10						
55.....	7.30	5.60	3.70		.30						
56.....	7.00	5.70	3.00		1.40						
57.....	7.00	5.80	4.10		2.00	.00					
58.....	7.70	6.00	4.0		2.20	.60					
59.....	7.00	6.10	4.40		2.30	.70					
60.....	8.00	6.20	4.60		2.40	.00					
61.....	8.10	6.40	4.60		2.40	1.00					
62.....	8.30	6.00	4.00		2.40	1.20					
63.....	8.60	00	5.10		3.10	1.40					
64.....	8.60	7.10	5.40		3.50	1.60				.10	
65.....	9.20	7.40	5.70		3.80	1.80				.30	
66.....	9.40	7.70	5.90		4.20	2.10				.00	
67.....	9.70	8.00	6.20		4.60	2.40				.00	
68.....	10.00	8.20	6.00		4.70	2.60				1.10	
69.....	10.30	8.50	6.00		5.00	3.00				1.30	
70.....	10.60	8.80	7.00		5.30	3.30				1.60	
71.....	10.80	9.10	7.30		5.70	3.70					
72.....	11.10	9.30	7.0		5.80	4.10					
73.....	11.40	9.60	7.80		6.10	4.30					
74.....	11.60	9.00	8.10		6.40	4.60				2.60	
75.....	11.10	10.10	1.40		6.60	4.0				2.60	
76.....	12.20	10.40	8.70		6.90	5.20				3.20	
77.....	12.40	10.70	8.90		7.20	5.40				3.60	
78.....	12.70	11.00	9.0		7.60	5.70				3.00	
79.....	13.00	11.20	9.0		7.70	6.00				4.20	
80.....	13.30	11.50	9.80		8.00	6.30				4.0	
81.....	13.00	11.80	10.00		8.00	6.30				4.80	
82.....	14.00	12.30	10.50		8.80	7.00				5.30	
83.....	14.70	13.00			9.40	7.70				5.90	
84.....	15.40	13.60	11.0		10.10	8.40				6.0	
85.....	16.10	14.30	12.60		18.0	9.10				7.30	
86.....	16.80	15.00			11.60	9.70				8.00	
87.....	17.40	15.70			12.0	10.40				8.70	
88.....	18.10	16.40			12.0	11.10				9.40	
89.....	18.80	17.10	15.30		13.50	11.0				10.00	
90.....	19.50	17.70	16.00		14.0					10.00	
91.....	20.20	18.40	16.70		14.0					11.40	
92.....	21.20	19.50	17.70		16.90					12.40	
93.....	22.60	20.80	19.10		17.30	10.00				13.0	
94.....	23.00	21.20	20.40		18.70	10.00				15.20	
95.....	23.30	21.80	21.80		20.00	18.30				16.50	
96.....	26.70	24.90	23.20		21.40	19.70				17.0	

14 percent of the excess over \$200 plus

27.40	1.0	23.0	22.1	0.30	18.	11.8	1.10	13.30	11.6	9.8
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"If the pay-roll period with respect to an employee is biweekly-

And the wages are—

And the number of withholding exemptions claimed is—

At least	But less than	The amount of tax to be withheld shall be—			
		1	2	3	4
\$0	20	11% of G	\$0	\$0	
	22		0	0	
	24	2.80	0	0	
	26	3.00	0	0	
	28	3.20	0	0	
	30	3.50	.40	0	
	32	3.70	.60	0	
	34	4.00	0	0	
	36	4.20	1.10	0	
	38	4.40	1.30	0	
	40	4.70	0	0	
	42	4.90	1.80	0	
	44	5.20	2.10	0	
	46	5.50	2.30	0	
	48	5.90	2.60	0	
	50	6.20	2.80	0	
	52	6.60	3.00	0	
	54	7.00	3.30	.20	
	56	7.30	3.50	.40	
	58	7.70	3.80	.70	
	60	8.00	4.00	.90	
	62	8.30	4.20	1.20	
	64	8.60	4.40	1.40	
	66	8.90	4.70	1.60	
	68	9.20	5.00	1.80	
	70	9.40	5.00	2.10	
	72	0.70	2.40	2.40	
	74	10.00	2.60	2.60	
	76	10.30	0.30	2.80	
	78	10.50	3.10	3.10	
	80	10.80	7.00	3.30	.20
	82	11.10	7.40	3.60	.50
	84	11.40	7.70	3.80	.70
	86	11.60	8.10	4.00	1.00
	88	11.90	8.40	4.30	1.20
	90	12.20	8.70	4.50	1.40
	92	12.40	8.90	4.80	1.70
	94	12.70	9.20	5.00	2.00
	96	13.00	3.50	5.30	2.20
	98	13.30	0.80	5.70	2.40
	100	13.60	1.00	6.00	2.60
	102	13.80	10.30	6.40	2.90
	104	14.10	10.60	6.70	3.10
	106	14.40	10.90	7.10	3.30
	108	14.60	11.10	7.0	3.60
	110	14.90	11.40	7.80	3.80
	112	15.20	11.70	8.20	4.10
	114	15.50	12.00	8.40	4.30
	116	15.70	12.20	8.70	4.60
	118	16.00	12.50	9.00	4.80
	120	16.30	12.80	9.30	5.00
	122	16.70	0.70	9.70	2.30
	124	17.20	10.20	6.30	2.80
	126	17.80	10.80	7.00	3.30
	128	18.30	11.30	7.70	3.80
	130	18.80	11.90	8.40	4.20
	132	19.40	15.90	12.40	8.00
	134	20.00	13.00	9.40	5.20
	136	20.60	17.00	13.60	10.00
	138	21.10	17.60	14.10	10.60
	140	21.60	18.10	14.60	11.10
	142	22.20	18.70	15.10	11.60
	144	22.70	19.20	15.60	12.10
	146	23.30	19.70	16.20	12.70
	148	23.80	20.30	16.80	13.30
	150	24.40	20.80	17.30	13.80
	152	25.00	21.40	17.90	14.40
	154	25.40	21.90	18.40	14.90
	156	26.00	22.50	19.00	15.50
	158	26.50	23.00	19.60	16.00
	160	27.10	23.60	20.10	16.60
	162	28.00	24.50	21.00	17.50
	164	29.40	25.90	22.40	18.90
	166	30.80	27.30	23.80	20.30
	168	32.10	28.60	25.10	21.60
	170	33.50	30.00	26.0	23.00
	172			19.50	16.00
	174			19.50	16.00
	176			19.50	16.00
	178			19.50	16.00
	180			19.50	16.00
	182			19.50	16.00
	184			19.50	16.00
	186			19.50	16.00
	188			19.50	16.00
	190			19.50	16.00
	192			19.50	16.00
	194			19.50	16.00
	196			19.50	16.00
	198			19.50	16.00
	200			19.50	16.00

REDUCTION OF INDIVIDUAL INCOME TAXES

if the payroll period with respect to an employee is biweekly-

And the wages are-

And the number of withholding exemptions claimed is-

At least	But less than	0	1	more																
\$260	\$260	31.40	27.00	24.40	20.00	17.30	13.80	10.00	6.40	2.00	0.00									
260	270	32.70	29.20	26.70	22.20	18.70	15.20	11.70	8.20	4.10	1.00									
270	280	34.10	30.60	27.10	23.60	20.10	16.60	13.10	9.60	5.40	2.20									
280	290	35.50	32.00	28.50	25.00	21.40	17.90	14.40	10.90	7.20	3.40									
290	300	40.00	36.80	33.30	29.80	26.30	22.80	19.30	15.80	12.30	8.80	4.60								
300	320	42.40	38.90	35.40	31.90	28.40	24.90	21.40	17.90	14.30	10.80	7.10								
320	340	45.10	41.00	38.10	34.60	31.10	27.60	24.10	20.0	17.10	13.60	10.10								
340	360	47.90	44.40	40.90	37.40	33.80	30.30	26.80	23.30	19.80	16.30	12.80								
360	380	50.60	47.10	43.60	40.10	36.60	33.10	29.60	26.10	22.60	19.10	15.50								
380	400	49.80	46.30	42.80	39.30	35.80	32.30	28.80	25.30	21.80	18.30									

14 percent of the excess over \$400 plus-

\$400 and over	51.20	47.70	44.20	40.70	37.20	33.70	30.20	26.70	23.20	19.70
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if the payroll period with respect to an employee is semi-monthly-

And the wages are-

And the number of withholding exemptions claimed is-

At least	But less than	0	1	2	3	4	5	6	7	8	9	10 or more
\$0	\$22	1.10										
22	24	3.00										
24	26	3.20										
26	30	3.50	.10									
30	32	3.70	.40									
32	34	4.00	.00									
34	38	4.20	.40									
38	40	4.70	1.10									
40	42	5.00	1.60									
42	44	5.10	1.80									
44	48	5.40	2.10									
48	50	5.70	2.30									
50	52	6.00	2.60	.20								
52	54	6.40	2.80	.40								
54	56	6.70	3.00	.70								
56	60	7.00	3.30	.90								
60	62	7.50	3.60	1.20								
62	64	7.80	3.70	1.40								
64	66	8.20	4.00	1.70								
66	68	8.50	4.20	1.90								
68	70	8.90	4.50	2.10								
70	72	9.20	4.70	2.30								
72	74	9.40	4.90	2.50								
74	76	9.70	5.20	2.70								
76	78	10.00	5.40	2.90								
78	80	10.30	5.70	3.10								
80	82	10.60	6.10	3.30								
82	84	10.80	6.40	3.50	.20							
84	86	11.10	6.80	3.80	.40							
86	88	11.40	7.10	4.00	.70							
88	90	11.60	7.60	4.30	.90							
90	92	11.90	7.00	4.60	1.20							
92	94	12.20	8.20	4.90	1.40							
94	96	12.40	8.0	5.20	1.70							
96	98	12.70	8.90	5.50	1.90							
98	100	13.00	9.20	5.70	2.20							
100	102	13.30	9.40	6.00	2.40							
102	104	13.60	9.70	6.20	2.60							
104	106	13.80	10.00	6.40	2.80							
106	108	14.10	10.30	6.70	3.00							
108	110	14.40	10.60	7.00	3.20							
110	112	14.60	10.80	7.30	3.40							
112	114	14.00	11.10	7.60	3.60							
114	116	15.20	11.40	7.90	3.80							
116	118	15.80	11.70	8.20	4.00							
118	120	16.00	11.90	8.40	4.20							
120	122	16.00	12.20	8.70	4.40							

"If the pay-roll period with respect to an employee is semimonthly-

And the wages are— And the number of withholding exemptions claimed is-

At least	but less than	The amount of tax to be withheld shall be—					
		1% of					
\$118a	\$120	\$16.30	\$2.50	\$8.60	\$4.30	\$.00	
\$120a	\$124	16.70	12.90	9.10	4.60	1.30	
\$124a	\$128	17.20	13.40	9.60	5.10	1.80	
\$128a	\$132	17.80	14.00	10.20	5.60	2.30	
\$132a	\$136	18.30	14.50	10.70	6.30	2.70	
\$136a	140	18.90	15.10	11.300	7.00	3.20	
\$140a	144	19.40	15.60	11.80	7.800	3.70	
\$144a	\$148	20.00	16.200	12.400	8.50	4.20	
\$148a	\$152	20.60	16.70	12.900	9.10	4.70	1.30
\$152a	\$156	21.10	17.30	13.0	9.70	5.10	1.80
\$156a	\$160	21.60	17.80	14.00	10.20	5.60	2.30
\$160a	\$164	22.20	18.40	14.50	10.80	6.40	2.60
\$164a	\$168	22.70	18.90	15.10	11.40	7.10	3.20
\$168a	\$172	23.30	19.50	15.70	11.90	7.80	3.70
\$172a	\$176	23.80	20.00	16.200	12.40	8.60	4.20
\$176a	\$180	24.40	20.600	16.80	13.00	9.20	4.70
\$180a	\$184	24.90	21.10	17.30	13.50	9.70	5.20
\$184a	\$188	25.40	21.60	17.80	14.00	10.20	5.70
\$188a	\$192	26.000	22.20	18.40	14.600	10.80	6.40
\$192a	\$196	26.50	22.70	18.90	15.10	11.30	7.00
\$196a	\$200	27.10	23.30	19.50	15.70	11.90	7.80
\$200a	\$204	28.00	24.20	20.40	16.60	12.80	9.00
\$204a	\$208	29.40	25.60	21.80	18.00	14.20	10.40
\$208a	\$212	30.80	27.00	23.20	19.40	15.60	11.80
\$212a	\$216	32.10	28.30	24.60	20.70	16.90	13.10
\$216a	\$220	33.50	29.70	26.00	22.10	18.30	14.50
\$220a	\$224	34.900	31.10	27.30	23.0	19.10	15.30
\$224a	\$228	36.30	32.0	28.70	24.90	20.70	17.30
\$228a	\$232	37.60	33.80	30.00	26.20	22.40	18.0
\$232a	\$236	39.00	35.20	31.40	27.60	23.80	20.00
\$236a	\$240	40.40	36.60	32.80	29.00	25.20	21.60
\$240a	\$244	42.40	38.60	34.80	31.00	27.20	23.40
\$244a	\$248	45.10	41.30	37.40	33.70	29.90	26.10
\$248a	\$252	50.0	44.10	40.30	36.50	32.70	30.90
\$252a	\$256	53.40	49.80	43.00	39.20	35.40	35.0
\$256a	\$260	56.10	52.30	48.0	42.00	38.20	38.40
\$260a	\$264	58.80	55.00	51.20	47.40	43.60	42.0
\$264a	\$268	61.60	57.80	54.00	50.20	46.40	45.0
\$268a	\$272	64.30	60.50	56.70	52.90	49.10	48.0
\$272a	\$276	67.00	63.20	59.40	55.60	51.80	51.0

If percent of the excess is over \$500 plus—

500 and over.....	68.40	64.60	0.80	57.00	53.20	49.4	45.0	41.8	38.0	34.20	30.40
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"If the pay-roll period with respect to an employee is monthly--

And the wages are— And the number of withholding exemptions claimed is-

At least	but less than	0	1	2	4	5	7	8	9	or more
\$14.....										
		6.00								
		7.40	.30							
		7.00	1.30							
\$12.....		8.40	1.70							
\$12.....		8.00	2.20							
\$8.....		9.30	2.70							
\$8.....		10.80	3.20							
\$9.....		11.30	4.60							
\$10.....		12.00	5.10							
\$10.....		12.80	5.60							
\$108.....		14.20	6.00							
\$112.....			6.50							

REDUCTION OF INDIVIDUAL INCOME TAXES

"If the pay-roll period with respect to an employee is monthly-

And the wages are--

And the number of withholding exemptions claimed is--

At least Dtole 0 | 1 2 3 4 5 6 7 8 9
The amount of tax to be withheld shall be--

Table with columns for wage amounts (e.g., \$110, \$120, \$130), exemption numbers (0-9), and resulting tax amounts. Includes a 'D' column for double amounts and a '1' column for 14% excess tax.

14 percent of the excess over \$1,000 plus

Summary table for wages \$1,000 and over, showing tax amounts for various exemption counts (0-9).

if the pay-roll period with respect to an employee is a daily pay-roll period or a miscellaneous pay-roll period--

And the wages divided by the number of days in such periods are--

And the number of withholding exemptions claimed is--

0	1	2	3
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But less than The amount of tax to be withheld shall be the following amount multiplied by the number of days in such period--

12% of \$0									
\$1.10	.20	.05	0						
\$1.75	.25	.05	0						
\$2.00	.30	.10							
\$2.75	.35	.15							
.00	.40	.20							
	.45	.25	.05	0					
	.50	.30	.05	0					
	.55	.35	.10	0					
	.60	.40	.10	0					
	.65	.45	.15	0					
\$3.00	.70	.50	.20	0					
\$3.50	.75	.55	.20	0					
\$4.25	.80	.60	.25	.05					
\$5.00	.85	.65	.30	.10					
\$5.75	.90	.70	.35	.15					
\$6.50	.95	.75	.40	.20					
\$7.25	1.00	.80	.45	.25					
\$8.00	1.05	.85	.50	.30					
\$8.75	1.10	.90	.55	.35	.055				
\$9.50	1.15	.95	.60	.40	.10				
\$10.25	1.20	1.00	.65	.45	.15				
\$11.00	1.25	1.05	.70	.50	.20				
\$11.75	1.30	1.10	.75	.55	.25				
\$12.50	1.35	1.15	.80	.60	.30				
\$13.25	1.40	1.20	.85	.65	.35				
\$14.00	1.45	1.25	.90	.70	.40				
\$14.75	1.50	1.30	.95	.75	.45	.05			
\$15.50	1.55	1.35	1.00	.80	.50	.10			
\$16.25	1.60	1.40	1.05	.85	.55	.15			
\$17.00	1.65	1.45	1.10	.90	.60	.20			
\$17.75	1.70	1.50	1.15	.95	.65	.25			
\$18.50	1.75	1.55	1.20	1.00	.70	.30			
\$19.25	1.80	1.60	1.25	1.05	.75	.35			
\$20.00	1.85	1.65	1.30	1.10	.80	.40			
\$20.75	1.90	1.70	1.35	1.15	.85	.45			
\$21.50	1.95	1.75	1.40	1.20	.90	.50			
\$22.25	2.00	1.80	1.45	1.25	.95	.55			
\$23.00	2.05	1.85	1.50	1.30	1.00	.60	.05		
\$23.75	2.10	1.90	1.55	1.35	1.05	.65	.10		
\$24.50	2.15	1.95	1.60	1.40	1.10	.70	.15		
\$25.25	2.20	2.00	1.65	1.45	1.15	.75	.20		
\$26.00	2.25	2.05	1.70	1.50	1.20	.80	.25	.05	
\$26.75	2.30	2.10	1.75	1.55	1.25	.85	.30	.10	
\$27.50	2.35	2.15	1.80	1.60	1.30	.90	.35	.15	
\$28.25	2.40	2.20	1.85	1.65	1.35	.95	.40	.20	
\$29.00	2.45	2.25	1.90	1.70	1.40	1.00	.45	.25	
\$29.75	2.50	2.30	1.95	1.75	1.45	1.05	.50	.30	
\$30.50	2.55	2.35	2.00	1.80	1.50	1.10	.55	.35	.05
\$31.25	2.60	2.40	2.05	1.85	1.55	1.15	.60	.40	
\$32.00	2.65	2.45	2.10	1.90	1.60	1.20	.65	.45	
\$32.75	2.70	2.50	2.15	1.95	1.65	1.25	.70	.50	
\$33.50	2.75	2.55	2.20	2.00	1.70	1.30	.75	.55	
\$34.25	2.80	2.60	2.25	2.05	1.75	1.35	.80	.60	.05
\$35.00	2.85	2.65	2.30	2.10	1.80	1.40	.85	.65	.10
\$35.75	2.90	2.70	2.35	2.15	1.85	1.45	.90	.70	.15
\$36.50	2.95	2.75	2.40	2.20	1.90	1.50	.95	.75	.20
\$37.25	3.00	2.80	2.45	2.25	1.95	1.55	1.00	.80	.25
\$38.00	3.05	2.85	2.50	2.30	2.00	1.60	1.05	.85	.30
\$38.75	3.10	2.90	2.55	2.35	2.05	1.65	1.10	.90	.35
\$39.50	3.15	2.95	2.60	2.40	2.10	1.70	1.15	.95	.40
\$40.25	3.20	3.00	2.65	2.45	2.15	1.75	1.20	1.00	.45
\$41.00	3.25	3.05	2.70	2.50	2.20	1.80	1.25	1.05	.50
\$41.75	3.30	3.10	2.75	2.55	2.25	1.85	1.30	1.10	.55
\$42.50	3.35	3.15	2.80	2.60	2.30	1.90	1.35	1.15	.60
\$43.25	3.40	3.20	2.85	2.65	2.35	1.95	1.40	1.20	.65
\$44.00	3.45	3.25	2.90	2.70	2.40	2.00	1.45	1.25	.70
\$44.75	3.50	3.30	2.95	2.75	2.45	2.05	1.50	1.30	.75
\$45.50	3.55	3.35	3.00	2.80	2.50	2.10	1.55	1.35	.80
\$46.25	3.60	3.40	3.05	2.85	2.55	2.15	1.60	1.40	.85
\$47.00	3.65	3.45	3.10	2.90	2.60	2.20	1.65	1.45	.90
\$47.75	3.70	3.50	3.15	2.95	2.65	2.25	1.70	1.50	.95
\$48.50	3.75	3.55	3.20	3.00	2.70	2.30	1.75	1.55	1.00
\$49.25	3.80	3.60	3.25	3.05	2.75	2.35	1.80	1.60	1.05

14 percent of the excess over \$30 plus--

\$30.00 and over.....	4.10	1.35	3.80	1.35	3.10	1.285	1.200	2.35	1.210	1.185	1.165
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SEC. 503. EFFECTIVE DATE.

The amendments made by this title shall be applicable only with respect to wages paid on or after April 1, 1948.

TITLE VI-FISCAL YEAR TAXPAYERS

SEC. 601. FISCAL YEAR TAXPAYERS.

Section 108 of the Internal Revenue Code is hereby amended by striking out "(d)" at the beginning of subsection (d) and inserting in lieu thereof "(e)", and by inserting after subsection (c) the following:

"(d) TAXABLE YEARS OF INDIVIDUALS BEGINNING IN 1947 AND ENDING IN 1948.—In the case of a taxable year of an individual beginning in 1947 and ending in 1948, the tax imposed by sections 11, 12, and 400 shall be an amount equal to the sum of—

"(1) that portion of a tax, computed as if the law applicable to taxable years beginning on January 1, 1947, were applicable to such taxable year, which the number of days in such taxable year prior to January 1, 1948, bears to the total number of days in such taxable year, plus

"(2) that portion of a tax, computed as if the law applicable to taxable years beginning on January 1, 1948, were applicable to such taxable year, which the number of days in such taxable year after December 31, 1947, bears to the total number of days in such taxable year."

Passed the House of Representatives February 2, 1948.

Attest:

JOHN ANDREWS, Clerk.

The CHAIRMAN. The committee has a letter dated March 1, 1948, from Mr. Wiggins, the Under Secretary of the Treasury. The letter states:

DEAR SENATOR MILLIKIN: Secretary Snyder, in compliance with your request, has asked that I submit the enclosed statement of his views with respect to H. R. 4790, which is to be the subject of hearings before your committee beginning this morning.

As you know, Secretary Snyder had planned in accordance with earlier arrangements made with you, to appear before the committee and personally present his views on March 11. The Secretary, therefore, made arrangements which would take him out of the city for a period prior to his scheduled appearance on that date.

Subsequently, on Thursday of last week you advised that you believed it necessary that the Secretary's views be presented on the opening day of the hearings. You were kind enough to suggest that under these circumstances, your committee would receive a written statement of the Secretary's views for presentation at the opening of the hearings this morning.

The Secretary asked me to convey his regrets that he could not be personally present this morning and his assurance that upon his return to the city he will be available in case the committee should desire his presence.

Sincerely,

A. L. M. WIGGINS,

Under Secretary of the Treasury.

The contents of the letter are in accordance with my own understanding.

The preliminary part of the Secretary's statement is relatively brief, and I believe it would give better understanding to the hearing if it were read into the record, and the rest of it, together with the part read, will be a part of the record. Therefore, I shall read the preliminary part of the Secretary's statement. [Reading:]

STATEMENT OF JOHN W. SNYDER, SECRETARY OF THE TREASURY

I am glad to have an opportunity to present to this committee my views on the House bill H. R. 4790. I shall confine my remarks to the more important issues raised by the bill.

REDUCTION OF INDIVIDUAL INCOME TAXES

The committee fully appreciates, I am sure, the compelling considerations which require me, as Secretary of the Treasury, to place the protection of the financial integrity of our Government above all other objectives. A sound financial structure is the essential cornerstone of the Nation's economy. Wise management of the Government's fiscal affairs will insure a continued contribution to hosting prosperity, to further industrial growth and expansion, and to higher standards of living. This requires that in considering tax reduction and tax revision we never lose sight of the paramount importance of preserving the strength of the revenue system at a level adequate to finance necessary Government services and to provide funds for servicing and reducing the national debt. I want to stress the importance of gearing any tax bill to the needs of the Government's basic financial policy. The Federal tax system must produce large amounts of revenue if essential domestic governmental services are to be maintained, the public debt reduced, our foreign commitments fulfilled. Premature weakening of our revenue system will involve serious consequences both for our domestic prosperity and for the peace of the world.

I recognize that postponement of tax reduction requires an unusual measure of self-denial. Each of us would welcome relief from the high taxes necessitated by the cost of the war. However, the financial consequences of the war are still with us. In addition to the normal expenses of running the Government there are heavy demands on the budget for national defense, the care of veterans, the servicing of the war debt, and the rehabilitation of war-torn countries.

The present tax system, in combination with high levels of employment and national income, resulted in a surplus of \$754,000,000 during the fiscal year ending June 30, 1947. In the current fiscal year the surplus will for the first time reach substantial proportions. This affords an opportunity to make a significant reduction in our large public debt. In his budget message, the President estimated that in fiscal year 1948 it will be possible to apply 7½ billion dollars to debt reduction. During the past 4 months, which included, of course, some of our best tax collection periods, we have used more than \$4,000,000,000 of the surplus to apply to debt reduction. This debt reduction would have been impossible had tax reduction proposed in H. R. 1 become effective last year.

For the fiscal year 1949, the anticipated decline in non-tax receipts, coupled with the increased expenditures projected in the President's budget will reduce the surplus available for debt reduction in that year to 4.8 billion dollars. I believe that this amount of debt reduction is desirable under present conditions of full employment and general prosperity. We must ever bear in mind the fact that the public debt of this country is in excess of \$250,000,000,000. If we continue to make the very best use of our opportunities, it will still take many years to make an appreciable dent in the size of the public debt. We must make sizable payments on the debt in good years for we know that there may be years in the future when no payments can be made.

Under current economic conditions it is essential to maintain the present level of Government receipts. This, however, does not preclude some readjustment in the distribution of the tax load. On the contrary, the persistence of high prices makes some readjustment imperative. During the second half of 1947 wholesale prices rose at an annual rate of 21 percent and consumer prices 13 percent. By the first of this year, wholesale prices were 45 percent and consumers' prices 25 percent higher than in June 1946.

Although the Nation is operating at peak levels and the country is enjoying higher standards of living than ever before, some groups in the population are suffering real hardship. These are not only families with relatively small fixed incomes but also others whose incomes have not kept pace with the increase in the cost of living. The problem, of course, is most serious for those in the lower income groups who have no appreciable savings to fall back on as a cushion against high prices.

Estimates of what people spend in relation to their income graphically illustrate the hardship suffered by low-income groups. It has been estimated that in 1946 about a third of the families with incomes below \$2,000 spent more than their income.

I should say that the Secretary's statement includes references to tables which company the report. [Reading.]

They financed consumption by dissipating accumulated savings and by going into debt. Under present conditions the taxes paid by the lowest income groups reduce the already inadequate incomes available for minimum living standards.

Tax reduction alone cannot provide adequate relief to **ills group**. But the right kind of tax adjustment call take some **contribution to the relief** of the plight of **low-income** people. Since fiscal and economic considerations preclude **any** reduction **in the** over-all strength of our tax system **relief** to this group should be provided by appropriate **increases in other taxes**.

The President recognized that inflation has brought real hardship to millions of families with low incomes and **recommended** a cost-of-living adjustment **in** the form of a **tax** credit of \$40 per capita. He recommended also that the revenue loss resulting from this adjustment should be made **up by increasing** the tax on corporate profits. As **I** indicated in **my** statement before **the** Ways and Means Committee:

"Under existing conditions, the fairest way of levying a **tax on corporate profits** which the President recommended would **be** to reenact the **excess-profits tax**, with a few modifications. The small corporations should be exempted by providing a specific exemption of \$50,000 of excess profits for **all** corporations. **The** rate should be reduced from the **855** percent **in effect for 1915** to **75** percent **and** the standards for normal profits, both the average earnings and **invested** capital credits, should be raised by **35** percent. With these modifications the tax would still **yield** **the** **32** billion dollars needed to offset the revenue loss resulting from **the** Individual **income-tax** cost-of-living adjustment. **The** tax would apply only to 22,000 corporations with the largest excess profits, **out of a total of 360,000** taxable corporations. **The** imposition of a **corporate** excess-profits tax to compensate in revenue for **the** cost-of-living tax adjustment **is** the most **equitable** way of maintaining **the** Federal revenues **at** their present strength and with the least adverse effect on our economy."

We cannot **escape** the obligation to **find** a source of replacement revenue to compensate for that **lost by** providing tax relief to low-income groups. **The** President's program **accomplishes this** through the **excess-profits tax**. **In** view of the record earnings of some **corporations**, this appears to **be** a sound solution both on equity **and economic** grounds. **I** do **not** know of **any** other course of replacement revenue that measures up to **the** required **tests**.

I now turn to **an** examination of the principal provisions of **H. R. 4790**. These provisions can be briefly stated.

The bill would increase personal exemptions from \$500 to \$600: would permit husbands **and** wives to divide their **incomes** equally for tax purposes; and would reduce tax rates by percentages ranging from 30 percent for taxpayers with small incomes to 10 percent for those with large incomes. **In** addition, **the** bill would grant a special \$600 exemption, **and** would increase the standard deduction for single persons **and** married couples **tiling** **joint** returns with adjusted gross incomes of over \$5,000. **The** bill also would reduce estate **and** gift taxes. For residents of **community-property** States the reduction would be achieved by restoring **the** law **in effect** prior to 1912. For residents of **common-law** States comparable reductions are achieved by permitting **deductions** for transfers of property between husbands **and** wives.

To assist **the** members of **the** committee **in** their consideration of **the** bill, **I** have appended to my statement **some** statistical materials **bearing on** its provisions.

H. R. 4790 results **in** excessive reductions and **a** deficit for fiscal year 1949. **The** bill would reduce individual **income-tax liabilities** by an estimated 6.2 billion dollars **in a** full year of operation, or by almost 30 percent of **the** 21.2 billion dollars total individual income tax liability under present law. **In** addition, estate **and** gift-tax liabilities would be reduced by \$250,000,000, which **is** also about 30 percent of the **estimated** \$820,000,000 estate and gift tax liabilities under present law.

If **H. R. 4790** were enacted the surplus of 7.5 billion dollars estimated **in** the President's budget for the fiscal year 1948 would be reduced by 1.1 billion dollars. **In** the fiscal year 1949 receipts would be decreased by 6.6 billion dollars **and** refunds increased by 400 million dollars. **This** would convert the **estimated** surplus of 4.8 billion dollars **in** fiscal year 1949 **into a** deficit of 2.2 billion dollars, necessitating **an** increase **in** the **public** debt.

None of the developments, which have occurred **since** the transmission of the President's Budget **message**, either those **in** the field of domestic prices or those **in** the field of international affairs, or otherwise, warrant changing the President's estimates of either receipts or **expenditures** to show a more favorable budget **picture**. No one can say with certainty **what any** future level of **income** will be. With relatively full **employment** **and** with our present production

facilities running at virtual capacity, it would not seem prudent to predicate estimates of receipts on a level of personal income higher than the 200-billion-dollar level of personal income utilized in preparing the estimates contained in the President's Budget message. The level of personal income in calendar year 1947 was 107 billion dollars.

Members of this committee will undoubtedly agree that there can be no justification for a tax program which would prevent adequate provision for a substantial retirement of the public debt in fiscal year 1949. This alone is sufficient reason for rejecting H. R. 4790.

H. R. 4790 would not increase current production. The proponents of H. R. 4790 claim that it would, by providing substantial individual income-tax reduction, overcome capital shortages and improve business incentives. I would be the first to recommend tax incentives if there were a present need to accelerate capital expansion. The fact is, however, that capital formation is at a high level and the number of businesses is increasing. In 1947, gross private domestic investment accounted for 27.8 billion dollars or 12.1 percent of the gross national product. This rate of investment compares with an average of 11.5 percent for the interwar period from 1919 to 1941. Outlays for producers' durable equipment accounted for almost 8 percent of the gross national product in 1947, a record rate, even including the 1920's. Moreover, the number of businesses has continued to increase since the low point reached during the war. By the end of 1947 they totaled almost 3,000,000, compared with the prewar peak of 3,400,000 and the wartime low of 2,800,000. These figures suggest that under current conditions there is no lack of business incentives.

There are times when tax incentives can play an important role in stimulating production. This fact should be recognized in the revision of the tax system for peacetime needs. Its potentialities should not be dissipated by poor timing. Today tax reduction is almost certain to raise prices by increasing consumer and investor competition for the limited supplies; it holds little promise of increasing production above the 1948 goals set in the President's economic report.

H. R. 4790 gives inadequate tax relief for the lowest income taxpayers; the relief is inequitably distributed. Another argument advanced in support of H. R. 4790 is that it gives adequate and correctly distributed relief. Under this bill, personal exemptions are increased by \$100 to compensate for a calculated \$100 decline in the purchasing power of the average income after taxes during the past 2 years.

These calculations do not provide an adequate measure of the need for tax relief in the lower income groups. Under the stress of war needs, personal exemptions were reduced to emergency levels. It was then recognized that the \$500 per capita exemption system would endanger the health and living standards of large segments of the population if retained for many years. Fiscal and economic considerations do not yet permit exemptions to be raised to a level compatible with long-term living standards, just as they preclude general tax reduction at this time. The national interest nonetheless requires sufficient immediate relief for those in greatest need to help tide them over this difficult period. In this respect H. R. 4790 stands in sharp contrast with the President's cost-of-living adjustment plan.

H. R. 4790 would exempt 6.3 million from income taxation in comparison with the 10.3 million exempted under the President's program. Moreover 13 million additional taxpayers with the lowest income would receive more tax reduction under the President's program than under H. R. 4790. These are the groups most urgently in need of relief from the high cost of living.

Under the President's program, 93 percent of the income-tax reduction would go to individuals with net incomes under \$5,000. This compares with 66.3 percent under H. R. 4790.

The pending bill would reduce tire taxes of those with net incomes in excess of \$5,000 by \$2,100,000,000 as against \$225,000,000 under the President's plan. It is my belief that we cannot go beyond a cost-of-living adjustment at this time. The \$2,100,000,000 tax reduction provided high-income taxpayers under H. R. 4790 goes far beyond this requirement.

The pending bill would also provide additional relief to the aged and the blind in the form of special exemptions. These and other low-income groups and disabled persons are hard-pressed by high prices. The cost-of-living adjustment recommended by the President is the most equitable way of providing tax relief to all these groups.

*H. R. 4790 equalizes income taxes in community-property and common-law States at the cost of substantial revenue but does not equalize estate and gift

taxes. The bill under consideration contains proposals designed to equalize income, estate, and gift-tax liabilities among taxpayers in community-property and common-law States.

With reference to the personal-income tax, the bill contains a provision which would permit married couples filing joint returns to divide their combined incomes equally in computing their income taxes. This is designed to eliminate a long-standing tax discrimination against married couples residing in noncommunity property States.

This provision is addressed to a problem which has acquired importance in recent years. Several common-law States have adopted community-property laws designed primarily to give their residents tax advantages previously enjoyed only in the original community-property States. As you know, I believe that this subject should be given a high priority among the structural changes in the Federal-tax system. In the current situation, however, it would be unwise to make this or other major structural changes which would result in substantial revenue losses. Splitting the incomes of husbands and wives would result in a loss of 97.5 percent of which would go to individuals with net incomes in excess of \$5,000.

With reference to the State and gift taxes, the bill would repeal the 1942 estate and gift tax community-property amendments. This would decrease the liabilities of married residents of those States by a relatively substantial amount. However, it is also proposed to provide similar relief for residents of common-law States, by amendments which it is hoped will produce relatively equal treatment with community-property States.

Prior to 1942, residents of community-property States paid relatively less estate and gift taxes than residents of other States. The 1942 act, in recognition of fundamental similarities in the family ownership of property in all the States, sought to correct this discriminating situation by equalizing the effects of the law under the different concepts of property ownership. It increased the transfer tax liabilities of community-property residents to approximately the level paid by residents of other States and generally succeeded in equalizing transfer tax liabilities among residents of all States.

This bill would replace the plan adopted in 1942 with a system, which is apparently intended to establish equality by reducing the transfer-tax liabilities of all persons to the level paid by community-property residents before 1942. It is my view that there is no valid basis for this change. While some difference in the impact of transfer taxes on residents of different States remain, these do not appear to lie of major significance. However, they could lie further narrowed, by relatively simple amendments within the framework of the present structure. The proposal, on the other hand, would create new areas of inequality and administrative problems that outweigh those remaining under present law.

The estate- and gift-tax provision, it has been said, is related to the split-income plan considered for purposes of income taxation. Any such relationship, if it exists at all, is superficial. The problems are not analogous or comparable.

In the income-tax field, residents of community-property and common-law States are not treated equally. The income-splitting plan is designed to remedy this situation by providing a single system of taxation applicable to all married residents of every State without exception. Moreover, it is also intended to go beyond removing the discrimination between community-property and common-law States by equalizing the now unequal tax treatment of family income from earnings and investments in all States.

An entirely different situation prevails in the estate- and gift-tax field. Present law already achieves substantial equality of treatment between common-law and community-property States.

This bill would reduce the revenue yield of the estate and gift taxes by as much as \$250,000,000. Economic and social requirements generally necessitate the needed reductions in many sectors of our tax system. It is also necessary to require a large segment of the population to bear tax burdens which impinge upon their living standards. Under these conditions the transfer-tax provisions of H. R. 4700 conflict with fairness and sound fiscal policy. Any structural revision of the system to remove inequities should be accomplished lawfully calculated not to weaken or further complicate the transfer taxes.

In view of the technical complexity of the estate- and gift-tax provision of H. R. 4700, I am submitting for the use of the committee a memorandum discussing the problem involved in greater detail.

H. R. 4700 would prejudice much needed tax revision. It is clear that any of the tax revisions required to modernize the American tax system will result

In a reduction of revenue. If the revenue system is prematurely weakened, our opportunities to improve it would be dissipated.

In his state of the Union message, the President said "When the present danger of inflation has passed, we should consider tax reduction based upon a revision of our entire tax structure."

On several occasions I have outlined the basic principles of taxation as follows: "I believe that a sound tax system should meet the following essential tests. The tax system should produce adequate revenue. It should be equitable in its treatment of different groups. It should interfere as little as possible with incentives to work and to invest. It should help maintain the broad consumer markets that are essential for high-level production and employment. Taxes should be as simple to administer and as easy to comply with as possible. While the tax system should be flexible and change with changing economic conditions, it should be possible to achieve this flexibility without frequent revisions of the basic tax structure. A stable tax structure, with necessary flexibility and largely to changes in tax rates and exemptions, will make it easier for business and Government to plan for the future."

While we cannot safely undertake this year the basic structural changes that will ultimately be desirable due to the large losses in revenue that are entailed, we can adopt many technical revisions which would move in the direction of an improved tax system. I urge upon the committee the desirability of undertaking the steps necessary to make such administrative and technical revisions as will clarify present tax laws and correct some of the existing inequities without any substantial loss of revenue. This can and should be done at an early date. Specific proposals along these lines have already been submitted by the Treasury Department to the House Committee on Ways and Means.

I am confident that sound tax policy can contribute an important measure to the continued prosperity of this country. I am also confident that your committee will give full consideration to the financial requirements and obligations of this Government. These considerations counsel against the adoption of H. R. 4700.

Following that statement, the Secretary has an analysis of the estate- and gift-tax provisions of H. R. 4700 and a series of exhibits. (They are as follows:)

ANALYSIS OF THE ESTATE AND GIFT TAX PROVISIONS OF H. R. 4700

Enactment of the estate and gift tax provisions of H. R. 4700 would be undesirable. Apart from causing unjustified revenue losses (involving a large portion of the total revenues from these taxes), these provisions would not establish the equality of transfer tax treatment of community property and noncommunity property which is said to justify the revenue loss; they would open the door to tax avoidance; they would create new administrative problems and complexities; and they would lead to disruption and distortion of well-established methods of property disposition in common-law States. Moreover, these amendments are not required as the counterpart of the proposed income splitting provisions for husbands and wives under the income tax. The following discussion will amplify these objections.

Discrimination

It is the principal purpose of the estate and gift tax amendments in the bill to restore the pre-1942 treatment of community property under which each spouse is recognized as owning one-half of the community property regardless of its source. Since mere repeal of the 1942 amendments governing the estate and gift tax treatment of community property would revive the former discrimination existing in favor of such property and against noncommunity property, the highly complicated provisions of sections 301 and 372 of the bill have been added in an attempt to provide equality of treatment for both types of property; i. e., it is intended to permit husbands and wives in common law States to divide their property equally with equivalent estate and gift tax results. To accomplish this, section 301 provides, in general, that there may be deducted from the gross estate of a deceased spouse the value of certain interests in property passing to the surviving spouse, but not to exceed one-half of the gross estate reduced by claims and similar deductions. Where, however, the estate of a spouse includes only his one-half interest in community property, no marital de-

REDUCTION OF INDIVIDUAL INCOME TAXES

duction would be allowed. Section 372 of the bill provides what is intended to be comparable gift tax treatment.

An analysis of these sections of the bill reveals that they not only fall to bring about equality of treatment, but in fact produce inequalities not present under existing law. Thus, where in a common-law State the estates of husband and wife are substantially equal and one dies leaving his property to the survivor, an estate tax would, by reason of the marital deduction, be payable on only one-quarter of the family wealth, i. e., on one-half of the decedent's half. However, in the corresponding situation in which the family wealth consists of community property earned by both spouses, an estate tax would be payable on the death of the first spouse to die with respect to one-half of the family wealth. Under these circumstances, a similar discrimination would result as to gifts made by one spouse to the other by reason of the gift tax marital deduction. This discrimination under both the estate and gift taxes is inherent in the approach to equalization set forth in the bill.

To take another example, a husband in New York who has earned all the family wealth may give half to his wife by gift, and, under the bill, pay gift tax on one-quarter. At death, he may leave his remaining half to the wife and pay estate tax on one-quarter. A husband in the same situation in Texas would pay no gift tax but would pay an estate tax on one-half at death. The sum of the gift tax on one-quarter and the estate tax on one-quarter in the case of the New York husband would be less than the estate tax on one-half in the Texas case, because of the lower brackets, lower gift-tax rates and two sets of exemptions. Thus, in this type of situation, community property would be discriminated against; there would continue to be inequality of treatment. On the other hand, where the New York husband gives one-half the family property to his wife during life, and the remaining half to his children at death, he would pay a gift tax on one-quarter and an estate tax on one-half of the property. The total taxes paid by the New York husband would exceed the estate tax payable by the Texas husband who left his half of the community property to his children and who was not required to pay gift tax on the half acquired by his wife by operation of law. In this case, the discrimination would run in the opposite direction, i. e., against common-law property.

Discrimination may also occur where the wife dies first. If the wife in Texas leaves to her surviving husband her half interest in community property earned solely by the husband, she would pay an estate tax on such half and the husband, at her death, would pay estate tax on the entire property. The New York wife would pay no tax at her death, an estate tax on the whole estate being payable upon the husband's subsequent death. In this situation, the total taxes paid by the spouses in Texas would be greater than the total taxes imposed will respect to the New York spouses' property. Conversely, the Texas family would have the advantage if the wife left her half of the community property to the children. In that case, the total taxes payable by the spouses owning community property would be an estate tax on the wife's half plus an estate tax on the husband's half, as compared with a tax, computed at higher progressive rates and with but a single exemption, on all the property of the New York husband.

These examples serve to demonstrate that title estate- and gift-tax amendments in the bill will not produce equality in the transfer-tax treatment of community and noncommunity property. Furthermore, a comparison of the tax consequences under the bill with those of the present law shows that the bill will produce inequalities where they do not exist under the present law.

Effect on estate planning

The method by which equalization is sought is inherently defective because the amount of the proposed marital deduction would depend on the amount of property going from the New York decedent or donor to his spouse. Thus, if only one-third of his property goes to his spouse, the amount of the deduction would be equal to the value of such one-third. In the case of community property, however, each spouse acquires title to one-half by operation of law. Equality, therefore, would be obtained under the system of taxation proposed in the bill only in the event the deceased or donor gives his spouse one-half of his property. Since it is a frequent practice in common-law States for a wealthy husband to give his wife a life interest in his estate with remainders to his children or other beneficiaries, equality of treatment would be achieved only by interfering to a large extent with this long-established pattern of family dispositions. No such criticism may properly be directed against time 1042 amendments.

Estate and gift tax provisions not necessary to income splitting

The estate and gift tax treatment of community and noncommunity property provided in H. R. 4790 is not, as has been suggested, a proper adjunct of the income-splitting provisions of the bill. The proposed system for income splitting by husbands and wives constitutes a single, Nation-wide plan for taxing income from all sources, whether derived from earnings or investments or from separate or community property. Such a plan is not concerned with local rules of ownership of income. Instead, it overrides such rules and sets forth a uniform concept for determining the tax on family income. The estate and gift tax provisions of the bill, however, do not create a single, over-all plan for taxing transfers of family wealth. On the contrary, the bill provides one method for taxing transfers of community property, based on the local rules of property ownership peculiar to such property, and another method for taxing noncommunity property, based on the local rules of property ownership peculiar to the latter property. The bill disregards the fact that by according full recognition to the formal distinctions between the two systems of property ownership, disparities of tax treatment necessarily arise. It then attempts, as a means of obtaining equality in the taxation of transfers of both types of property, to conform transfers of noncommunity property to the pattern of transfers peculiar to the community-property system, through the use of a marital deduction. Equality of taxation cannot be successfully achieved through a hybrid-tax system, such as that created by H. R. 4790, which implements rather than disregards the formalities and technicalities of local rules of property ownership.

Terminable interests

The hybrid plan for taxing transfers contained in the bill is fundamentally defective in another important respect. Sections 301 and 372 disallow a marital deduction with respect to certain terminable interests in property passing to a surviving spouse, or transferred by gift. Typical examples of terminable interests which are not deductible are life estates or annuities given to a spouse, where remainder interests pass to other beneficiaries. Thus, where a decedent leaves property in trust, providing for the payment of the income from the trust to his wife for life with remainder to his children, no marital deduction may be taken. The apparent purpose of this rule is to insure that all the property of the family is included in either the estate of the husband or of the wife.

The difficulty is that the husband may easily avoid this rule by use of other types of terminable interests which are deductible under the bill. The bill permits the deduction of terminable interest purchased by the donor or decedent or by the executor at the direction of the decedent. This creates a wide avenue for avoidance of tax upon either spouse. Thus a person who wishes to provide a life income for his spouse with remainder to his children without losing the benefit of the marital deduction need only purchase, or direct his executor to purchase, a life annuity for his spouse with part of his estate and to hold the balance in trusts for the children. The value of such annuity would be a marital deduction from the decedent's gross estate, and would not thereafter be includible in his spouse's gross estate. The value of the annuity would thus completely escape taxation. Tax could similarly be avoided in the case of other purchased terminable interests such as leases and insurance proceeds payable in installments.

On the other hand, if the marital deduction were not allowed as to any terminable interest, so that there would be deductible only such property transferred to a spouse as would be subject to transfer tax in her estate, a further large area of inequality of treatment as between common-law and community-property States would be created, in view of the fact that terminable interests may be held as community property. This dilemma appears to be inherent in the "equalization" plan of the bill. The 1942 amendments present no such problem.

Tracing of property

One of the chief arguments advanced by proponents of the repeal of the 1942 amendments governing community property is the supposed difficulty in some instances in tracing such property to its source. While the existing problem does not in fact appear to be serious, this bill itself substitutes some new tracing requirements.

Sections 301 and 372 of the bill properly provide that no marital deduction be taken as to separate property which was at any time acquired in exchange or through partition of community property. It is apparent that, under these provisions, it will frequently be necessary to trace separate property passing between spouses back to its original source. Accordingly, to the extent that the criticisms

of the 1942 amendments based on tracing difficulties may be valid, H. R. 4790 is open to the same type of criticism.

Basis

In addition to the difficulties in the estate- and gift-tax treatment of spouses, the plan incorporated in the bill also gives rise to income-tax problems involving basis for gain or loss. Under existing law the basis of property acquired by a surviving wife by bequests, devise, or inheritance from her deceased husband would be its value at time of his death. The bill makes no change in the rule, even though the marital deduction taken by the husband results in exclusion of the property, from his taxable estate. In the case of community property, however, the surviving wife's basis for her half of the community, however, the surviving wife's basis for her half of the community property would be its cost to the community, since such half was not acquired by bequest, devise, or inheritance. Where the property has appreciated in value this operates disadvantageously to community property.

In determining the appropriate policy respecting basis, consideration must be given to the relationship between noncommunity property qualifying for a marital deduction and the surviving spouse's interest in community property. The plan of estate taxation embodied in H. R. 4790 treats property passing to a surviving spouse and qualifying for a marital deduction as the equivalent of a surviving spouse's interest in community property. Accordingly, it may be presumed that similar basis treatment should be given to both types of property. Similar treatment, however, cannot be achieved if the estate-tax plan of H. R. 4790 is not accompanied by a change in the present provisions of law governing basis. The bill fails to deal with this question.

If, in spite of their fundamental and serious defects, the estate- and gift-tax provisions of this bill should be enacted, it would appear that a satisfactory basis for determining gain or loss could only be established by eliminating entirely the provisions of existing law which permit the basis of inherited property to be determined by reference to the value of the property at the time of death. This type of treatment would provide equality for income-tax purposes of both community and noncommunity property.

Other technical defects

The bill in its present form does not deal with a number of troublesome technical problems which must be resolved and presumably will be by amendment. These involve matters relating to proper allowance of credit for gift tax in the case of property subject to the marital deduction, cases of disclaimers of legacies and other matters. However, even assuming that these problems are satisfactorily disposed of, it must be recognized that their solution will unquestionably lengthen and further complicate the estate- and gift-tax provisions of the bill, which already are far more lengthy and complex than can be justified by the tax results they achieve.

EXHIBIT 1

Estimated effect of House bill (H. R. 4790) on budget receipts, expenditures, and surplus, fiscal years 1948 and 1949

(In billion of dollars)

	Receipts	Expenditures	Surplus or deficit
Fiscal year 1948:			
Present law	\$452	\$37.7	7.8
House bill (H. R. 4790)	44.1	37.7	0.4
Decrease under House bill (H. R. 4790)	1.1		1.1
Fiscal year 1949:			
Present law	44.5	0.7	4.8
House bill (H. R. 4790)	37.9	40.1	-2.3
Decrease under House bill (H. R. 4790)	6.6	3.4	7.0

(Internal Revenue Code, as amended by the Revenue Act of 1948. Represents increase resulting from larger individual income tax refunds under H. R. 4790.)

Source: Estimates under present law are from the Budget of the United States Government for the fiscal year ending June 30, 1949.

EXHIBIT

Wholesale, retail, and consumers' price indexes, 1989 to date

Year or month	Wholesale prices (1926=100)	Retail prices (1935-39=100)	Consumers' prices (1935-39=100) ¹		
			All items	Food	Clothing
Monthly average:					
1936.....	77.1	99.0	99.4	95.2	100.5
1940.....	78.6	100.6	100.2	96.6	101.7
1941.....	87.3	108.3	105.22	105.5	106.3
1942.....	98.8	124.9	116.8	123.9	124.2
1943.....	103.1	134.0	123.6	138.0	129.7
194.....	104.00	137.6	125.5	136.1	138.8
1915.....	105.8	141.4	128.4	139.1	145.9
1916.....	121.1	155.0	139.3	159.6	160.2
1917.....	151.7		189.2	193.8	185.8
1918-January.....	107.1	143.1	129.9	141.0	149.7
February.....	107.7	142.9	129.6	139.6	150.6
March.....	108.9	143.7	130.2	140.1	153.1
April.....	110.2	144.1	131.1	141.7	154.6
May.....	111.0	145.7	131.7	142.6	155.7
June.....	112.9	147.7	133.3	145.6	157.2
July.....	124.7	156.8	141.2	165.7	158.7
August.....	129.1	159.8	144.1	171.2	161.2
September.....	124.0	164.3	145.9	174.1	165.0
October.....	134.1	167.2	148.6	180.0.0	168.1
November.....	139.7	171.5	152.2	187.7	171.0
December.....	140.9	172.7	153.3	185.9	176.5
1919-January.....	141.5	172.7	153.3	183.8	179.0
February.....	144.5	172.7	153.2	182.3	181.5
March.....	140.5	177.2	156.3	189.5	184.3
April.....	142.77	177.2	156.2.2	188.0	184.9
May.....	147.1	177.1	156.0	187.6	185.0
June.....	147.1	178.7	157.1	190.5	185.7
July.....	150.1	179.7	158.4	193.1	184.7
August.....	153.6	181.4	160.3	196.5	185.9
September.....	157.4	184.9	163.8	203.5	187.6
October.....	155.5	184.9	163.8	201.6	189.0
November.....	159.7	185.9	164.9	202.7	190.2
December.....	163.2	(b)	167.0	206.9	191.2
1920-January.....	165.6	(b)	168.8	209.7	192.1

¹ For moderate-income families in large cities.

² Not available.

Source: Wholesale and consumers' prices, U. S. Department of Labor; retail prices, U. S. Department of Commerce

EXHIBIT 3

Percentage distribution of positive and negative savers, by income groups of family units, 1946

Income groups ¹	All family units	Positive savers ²	Zero savers	Negative savers
All family units ³	100	66	7	27
Under \$1,000.....	100	39	28	33
1,000 to \$1,999.....	100	57	10	33
2,000 to \$2,999.....	100	65	3	32
3,000 to \$3,999.....	100	75	2	23
4,000 to \$4,999.....	100	78	0	22
5,000 to \$7,499.....	100	81	1	18
7,500 and above.....	100	83	(4)	12

¹ Based on 1946 money income before taxes.

² Family units with money incomes in excess of expenditures.

³ Family units with expenditures in excess of money incomes.

Includes families of one or more persons.

⁴ L than one-half of 1 percent.

Source: Survey of Consumer Finances, pt. III, Consumer Savings in 1946 and Ownership of Selected Non-liquid Assets, Federal Reserve Bulletin, August 1947, table 13, p. 12.

EXHIBIT 4

Gross national product and gross private domestic investment, 1929-47

(In billions of dollars)

Year or quarter	Gross national product	Gross private domestic investment			
		Total	New construction	Producers' durable equipment	Changes in business inventories
1929	103.8	15.8	7.8	6.4	1.6
1930	90.9	10.2	5.6	4.9	-3
1931	75.0	4	3.6	3.2	-1.4
1932	68.3	.9	1.7	1.8	-2.0
	68.8	1.3	1.1	1.8	.
	4.9	2.8	1.4	2.5	.
1933	72.2	6.1	1.9	3.4	.9
1934	82.6	8.3	2.8	4.5	1.0
1937	90.2	11.4	3.7	6.4	2.3
1938	84.7	6.3	3.3	4.0	-1.0
1939	90.4	9.0	4.0	4.6	.4
1940	100.	13.0	4.6	6.1	23-
1941	125.3	17.2	5.7	7.7	3.9
1942	159.6	9.3	3.2	4.7	1.4
1943	192.6	4.6	2.0	3.8	-1.2
1944	210.6	6.7	2.3	5.3	-2.0
1945	213.1	9.1	3.1	7.1	-1.2
1946	203.7	24.6	8.5	12.4	3.7
1947	229.6	27.8	10.7	17.9	-7

SEASONALLY ADJUSTED ANNUAL RATES

I	191.7	18.6	7.2	9.1	2.3
II	197.0	22.3	8.7	11.5	2.0
III	207.5	27.0	8.9	13.2	4.9
IV	218.6	30.4	9.3	15.7	5.4
1947:					
I	221.0	28.2	10.3	16.4	1.6
II	226.9	26.1	9.6	17.9	-1.4
III	229.4	27.0	10.4	18.4	-1.7
IV	240.9	29.9	12.4	18.8	-1.3

Note.— Figures are rounded and will not necessarily add to totals.
Source: U. S. Department of Commerce.

EXHIBIT 5

Gross private domestic investment, total and major components as percentages of gross national product, 1919-47

Year or quarter	Gross national product	Gross private domestic investment			
		Total	New construction	Producers' durable equipment	Changes in business inventories
1919	100.0		4.8		4.1
1920	100.0		5.65		6.85
1921	100.0		6.0		7
1922	100.0		7.8		3.7
1923	100.0		8.4		4.3
	100.0		9.3		-1.3
1924	100.0		9.6		4.7
1925	100.0		9.7		1.6
1927	100.0		9.6		3
1928	100.0		9.6		2
1929	100.0		7.8		1.5
1930	100.0		4.7		-2.5
1931	100.0		2.9		-2.8
1932	100.0		2.9		-1.7
1933	100.0		2.9		1.3
1934	100.0		2.9		1.3
1935	100.0		2.85		1.2
1936	100.0		3.4		

EXHIBIT 5-Continued

From private domestic investment total and major components as percentages of gross national product, 1919-47—Continued

[In billions of dollars]

Year or quarter	Gross product	Gross private domestic investment			
		New construction	Producers' equipment	Consumer business	
1937.....	100.0	12.6	4.1	6.0	2.5
1938.....	100.0	7.4	3.9	4.7	-1.2
1939.....	100.0	9.9	4.4	4.1	.4
1940.....	100.0	13.0	4.6	6.1	2.3
1941.....	100.0	13.7	4.5	6.1	3.1
1942.....	100.0	8.8	2.0	2.9	.9
1943.....	100.0	2.4	1.0	2.0	-.6
1944.....	100.0	2.7	1.1	2.5	-.9
1945.....	100.0	4.3	1.5	3.4	-.6
1946.....	100.0	12.1	4.2	6.1	1.8
1947.....	100.0	12.1	4.7	7.8	-.3
Annual average 1919-41.....	100.0	11.5	5.8	5.1	.7

SEASONALLY ADJUSTED ANNUAL RATES

1946:					
I.....	100.0	9.7	3.8	4.7	1.2
II.....	100.0	11.3	4.4	5.8	1.0
III.....	100.0	13.0	4.3	6.4	2.4
IV.....	100.0	13.9	4.3	7.2	2.5
1947:					
I.....	100.0	12.8	4.7	7	.7
II.....	100.0	11.5	4.2	7.	-.6
III.....	100.0	11.8	4.6	8.0	-.7
IV.....	100.0	12.4	5.1	7.8	-.5

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

Source: U. S. Department of Commerce.

EXHIBIT 6

Number of operating business firms, 1939-47

Year or quarter ¹	Number of operating firms	Year or quarter ¹	Number of operating firms
1939.....	3,316,700	1945—Continued.	
1940.....	3,298,200	III.....	3,134,100
1941.....	3,398,000	IV.....	3,224,100
1942.....	3,155,700	1946:	
1943:		I.....	3,869,100
III.....	2,860,600	II.....	3,494,700
IV.....	2,835,600	III.....	3,695,300
1944:		IV.....	3,657,800
I.....	2,848,300	1947:	
II.....	2,879,900	I.....	3,731,400
III.....	2,923,600	II.....	3,783,600
IV.....			(*)
1945:		IV.....	3,871,400
I.....	3,012,900		
II.....	3,062,800		

¹ Annual figures are as of Sept. 30 of the indicated year; quarterly figures are as of the end of the quarter.

² Preliminary.

³ Not available.

⁴ Estimated.

Source: U. S. Department of Commerce.

EXHIBIT 7

TABLE 1.—Comparison of amounts and effective rates of individual income tax under present law,¹ the House bill (H. R. 4790), and the \$40 per capita tax credit, for selected amounts of net income under \$5,000

SINGLE PERSON -NO DEPENDENTS

Amounts before personal exemption	Amounts of tax			Effective rates			Decrease in amounts of tax compared with present law		Decrease in effective rates compared with present law		Tax decrease as a percentage of present tax liability		Tax decrease as a percent of net income after present tax liability	
	Present law	House bill (H. R. 4790)	\$40 per capita tax credit	Present law	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit
				Percent	Percent	Percent			Percent	Percent	Percent	Percent	Percent	Percent
\$00.....	\$19	0	0	3.2	0	0	\$19	\$19	3.2	3.2	100.0	100.0	3.3	3.3
00.....	38	\$13	0	5.4	1.9	0	25	38	3.5	5.4	65.0	100.0	3.7	5.7
80.....	76	-7	\$17	7.1	3.3	2.1	3	40	3.8	0	3	70.2	4.1	5.4
200.....	89	49	36	9.4	4.4	4.0	40	40	4.0	4.4	47.5	52.3	4.4	4.9
\$988 ²	85	33	55	9.5	5.1	5.1	40	40	4.1	4.1	45.0	47.5	4.5	4.6
\$1,000.....	89	33	55	9.5	5.1	5.1	40	40	4.2	4.0	44.0	42.1	4.6	4.4
\$1,200.....	133	80	93	11.1	6.7	7.8	55	40	4.4	3.3	40.0	30.1	5.0	3.7
\$1,500.....	190	120	150	12.7	8.0	10.0	70	40	4.7	2.7	37.0	21.1	5.4	3.1
\$2,000.....	285	213	246	14.3	11.6	12.3	72	40	3.6	2.0	25.3	14.0	4.2	2.3
\$2,500.....	390	289	340	15.2	12.4	13.6	91	40	3.6	1.6	24.0	10.5	4.3	1.9
\$3,000.....	485	371	445	16.2	13.0	14.8	114	40	3.8	1.3	23.5	8.3	4.5	1.6
\$3,500.....	589	454	549	16.8	13.0	15.7	135	40	3.8	1.1	22.8	6.8	4.6	1.4
\$4,000.....	684	538	654	17.3	12.5	16.3	155	40	3.9	1.0	22.4	5.8	4.7	1.2
\$4,500.....	798	622	758	17.7	13.8	16.8	176	40	3.9	0	22.1	5.0	4.8	1.1
\$5,000.....	812	737	882	18.4	14.5	17.6	194	40	3.9	.8	21.1	4.3	4.8	1.0

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.
² Single person not entitled to the special exemption for either the aged or the blind.
³ Assume tax rate 15%.
⁴ Point at which the tax under H. R. 4790 is the same as the tax under the \$40 per capita tax credit.

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TABLE 2.—Comparison of amounts and effective rates of individual income tax under present law, the House bill (H. R. 4790) and the \$40 per capita tax credit for selected amounts of net income under \$5,000

MARRIED PERSON—NO DEPENDENTS

Net income before personal exemption	Amounts of tax			Effective rates			Decrease in amounts of tax compared with present law		Decrease in effective rates compared with present law		Tax decrease as a percentage of present tax liability		Tax decrease as a percentage of net income after present tax liability	
	Present law	House bill (H. R. 4790)	\$40 per capita tax credit	Present law	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit
\$1,200	\$38	0	0	Percent 3.2	Percent 0	Percent 1.0	\$38	\$38	Percent 3.2	Percent 3.2	Percent 100.0	Percent 100.0	Percent 3.3	Percent 3.3
\$1,500	95	\$40	\$15	6.3	2.7	1.0	55	80	3.7	5.3	58.0	84.2	3.9	5.7
\$1,600	114	53	34	7.1	3.3	2.1	61	80	3.8	5.0	53.3	70.2	4.1	5.2
\$1,700	133	67	53	7.8	3.9	3.1	67	80	3.9	4.7	50.0	60.2	4.2	5.1
\$1,800	152	80	72	8.4	4.4	4.0	72	80	4.0	4.4	47.8	52.6	4.4	4.9
\$1,900	171	93	91	9.2	4.9	4.8	78	80	4.1	4.2	45.6	48.8	4.5	4.6
\$1,937 ¹	178	98	98	9.5	5.1	5.1	80	80	4.1	4.1	44.9	44.9	4.6	4.5
2,000	190	109	110	11.4	5.3	5.5	84	80	4.2	4.0	44.0	42.1	4.6	4.4
\$2,500	380	239	205	12.7	6.9	8.2	112	80	4.5	3.2	39.3	28.1	5.1	7.2
\$3,000	500	300	300	13.8	9.3	10.0	141	80	4.7	2.7	37.0	21.1	5.2	8.1
\$3,500	619	329	405	14.7	10.6	11.6	159	80	4.5	2.3	32.7	18.8	5.3	2.7
\$4,000	738	426	509	15.4	11.1	12.7	163	80	4.1	2.0	27.7	13.6	5.3	2.7
\$4,500	857	502	614	16.0	11.6	14.4	192	80	4.3	1.0	27.7	11.5	5.0	2.1
100	798	528	718	16.0	11.6	14.4	220	80	4.4	1.0	27.6	10.0	5.0	1.0

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.

² Assumes only 1 spouse has income.

³ Assumes taxpayer is not entitled to the special exemption for either the aged or the blind.

⁴ Point at which the tax under H. R. 4790 is the same as the tax under the \$40 per capita tax credit.

TABLE 3.—Comparison of amounts and effective rate of individual income tax under present law, the House bill (H. R. 4790), and the \$40 per capita tax credit, for selected amounts of net income under \$5,000

MARRIED PERSON 1-2 DEPENDENTS

Net income before personal exemption	Amounts of tax			Effective rates			Decrease in amounts of tax compared with present law		Decrease in effective rates compared with present law		Tax decrease as a percentage of present tax liability		Tax decrease as a percentage of net income after present tax liability	
	Present law	House bill (H. R. 4790) ¹	\$40 per capita tax credit	Present law	House bill (H. R. 4790) ²	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit	House bill (H. R. 4790)	\$40 per capita tax credit
				Percent	Percent	Percent			Percent	Percent	Percent	Percent	Percent	Percent
2,400	\$76	0	0	3.2	0	0			3.2	3.2	100.0	100.0	3.3	3.3
	152	\$53	0	5.4	1.9	0	99	152	3.5	5.4	65.0	100.0	3.7	5.7
	190	80	0	8.1	2.7	0	139	160	3.7	5.3	58.00	84.2	3.9	5.7
	228	146	125	4.2	4.2	3.6	159	160	4.0	4.6	48.7	52.1	4.3	5.0
	304	160	144	8.4	4.4	4.0	144	160	4.0	4.4	47.5	52.6	4.4	4.9
	342	173	163	8.7	4.7	4.4	150	160	4.1	4.3	46.5	49.5	4.4	4.7
	356	186	195	9.0	4.9	4.8	156	160	4.1	4.2	45.6	46.8	4.5	4.6
	381	196	205	9.2	5.1	5.1	160	160	4.1	4.1	44.9	44.9	4.5	4.5
	380	204	201	9.3	5.2	5.2	162	160	4.1	4.1	44.7	44.3	4.6	4.5
	485	213	220	9.5	5.3	5.5	167	160	4.2	4.0	44.0	42.1	4.6	4.4
	485	286	325	10.8	6.4	7.2	199	160	4.4	4.6	41.0	33.0	4.9	4.0
	589	386	429	11.8	7.7	8.6	203	160	4.1	3.2	34.5	27.2	4.6	3.6

¹ Internal Revenue Code, as amended by the Revenue Act of 1941

² Assumes only 1 spouse has income.

³ Assumes taxpayer is not entitled to special exemption for either the aged or the blind.

⁴ Point at which the tax under H. R. 4790 is the same as the tax under the \$40 per capita tax credit.

EXHIBIT 8

TABLE 01.—*Comparison of amounts and effective rates of individual income tax under present law¹ and under the \$40 per capita tax credit*

SINGLE PERSON—NO DEPENDENTS

Net income before personal exemption	Amounts of tax		Effective rates		Decrease in amounts of tax compared with present law	Decrease in effective rates compared with present law	Tax decrease as a percent of present tax liability	Tax decrease as a percentage of net income after present tax liability
	Present law	\$40 per capita tax credit	Present law	\$40 per capita tax credit				
\$800	0	\$17	5.4	0	\$38	5.4	100.0	5.7
1,000	27	55 ^b	9.5	5.5	40	5.00	70.2	5.4
1,200	100	95	11.1	7.8	40	4.0	42.1	4.4
	160	127	12.7	10.0	40	33	30.1	3.7
	245	143	14.3	12.3	40	2.7	21.1	3.1
\$2,500	380	245	15.2	13.6	40	2.0	14.0	2.3
\$3,000	485	445	16.2	14.8	40	1.6	10.5	1.9
	694	654	17.3	16.3	40	1.3	7.3	1.6
	882	842	18.4	17.6	40	1.0	5.8	1.2
	1,160	1,120	19.5	18.8	40	.8	4.3	1.0
	1,720	1,680	21.5	21.0	40	.7	3.4	.8
\$10,000	2,347	2,307	23.5	23.1	40	.6	2.3	.6
\$15,000	4,270	4,230	28.6	28.2	40	.4	1.7	
\$20,000	6,645	6,605	33.2	33.0	40	.3	1.0	.4
	9,362	9,322	37.4	37.3	40	.2	.4	.3
\$25,000	12,137	12,097	40.3	40.2	40	.2	.2	.3
\$30,000	14,477	14,437	43.0	42.9	40	.1	.1	.2
\$35,000	16,341	16,301	45.6	45.5	40	.1	.1	.1
\$40,000	17,772	17,732	46.7	46.7	40	.1	.1	.1
\$45,000	18,822	18,782	47.5	47.5	40	.1	.1	.1
\$50,000	19,897	19,857	48.2	48.2	40	.1	.1	.1
\$55,000	21,022	20,982	48.8	48.8	40	.1	.1	.1
\$60,000	22,147	22,107	49.4	49.4	40	.1	.1	.1

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.
² Less than 0.05 percent.

TABLE 2.—*Comparison of amounts and effective rates of individual income tax under present law¹ and under the \$40 per capita tax credit*
 MARRIED PERSON—NO DEPENDENTS

Net income before personal exemption	Amounts of tax		Effective rates		Decrease in amounts of tax compared with present law	Decrease in effective rates compared with present law	Tax decrease as a percent of present tax liability	Tax decrease as a percentage of net income after present tax liability
	Present law	\$40 per capita tax credit	Present law	\$40 per capita tax credit				
1,400	\$75	0	5.4	0	\$76	5.4	100.0	5.7
1,500	95	\$15 ^b	6.3	1.0	80	5.3	84.2	5.7
2,000	190	110	9.5	5.5	80	4.0	42.1	4.4
2,500	285	205	11.4	7.2	80	3.2	28.1	3.6
3,000	380	30 ^b	12.7	10.0	80	2.7	21.1	3.1
4,000	580	50	14.7	12.3	80	2.0	14.0	2.3
5,000	780	718 ^b	16.0	14.4	80	1.6	10.0	1.9
6,000	1,045	985	17.4	16.1	80	1.2	7.7	1.6
7,000	1,377	1,297	19.7	18.7	80	1.0	5.1	1.2
10,000	2,185	2,105	21.9	21.1	80	.8	3.7	1.0
15,000	4,047	3,967	27.0	26.4	80	.6	2.0	.7
20,000	6,394	6,314	32.0	31.6	80	.4	1.3	.6
25,000	9,062	9,002	36.3	36.0	80	.3	.9	.5
30,000	12,137	12,117	40.6	40.6	80	.2	.5	.3
35,000	14,730	14,710	44.8	44.8	80	.1	.2	.2
40,000	17,015	17,015	48.1	48.1	80	.1	.1	.1
45,000	19,060	19,060	50.9	50.9	80	.1	.1	.1
50,000	21,020	21,020	53.5	53.5	80	.1	.1	.1
55,000	22,900	22,900	55.9	55.9	80	.1	.1	.1
60,000	24,715	24,715	58.1	58.1	80	.1	.1	.1
65,000	26,485	26,485	60.2	60.2	80	.1	.1	.1
70,000	28,220	28,220	62.1	62.1	80	.1	.1	.1
75,000	29,915	29,915	63.8	63.8	80	.1	.1	.1
80,000	31,580	31,580	65.3	65.3	80	.1	.1	.1
85,000	33,215	33,215	66.7	66.7	80	.1	.1	.1
90,000	34,820	34,820	68.0	68.0	80	.1	.1	.1
95,000	36,400	36,400	69.2	69.2	80	.1	.1	.1
100,000	38,000	38,000	70.4	70.4	80	.1	.1	.1
0	839,71	839,635	84.0	84.0	800			

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.
² Assume only 1 spouse has income.
³ Less than 0.05 percent.

TABLE 3.—Comparison of amounts and effective rates of individual income tax under present law¹ and under the \$40 per capita tax credit

MARRIED PERSON, 1-2 DEPENDENTS

Net income before personal exemption	Amounts of tax		Effective rates		Decrease in amount of tax compared with present law	Decrease in effective rates compared with present law	Tax decrease as a percentage of present liability	Decrease as a percentage of net after-tax liability
	Present law	\$40 per capita tax credit	Present law	\$40 per capita tax credit				
\$2,500	\$955	0	3.8	0	\$953	3.8	100.0	4.0
300	152	0	5.4	0	152	5.4	100.0	5.7
190	380	0	6.3	1.0	160	5.3	84.2	5.7
000	380	220	9.5	5.5	160	4.0	42.1	4.4
589,000	429	0	11.8	8.6	160	3.0	27.2	3.6
16,000	798	698	3.3	10.6	160	2.7	20.1	3.1
8,000	1,294	1,132	19.2	14.2	160	2.0	12.4	2.4
10,000	1,862	1,702	18.6	17.0	160	1.6	8.0	2.0
1,000	3,639	3,479	24.3	22.9	160	1.1	4.4	1.4
20,000	5,890	5,730	29.5	28.7	160	.8	2.7	1.1
30,000	8,522	8,362	33.1	33.4	160	.6	1.9	1.0
50,000	21,111	20,951	48.2	47.9	160	.3	.7	.6
75,000	42,323	42,163	56.4	56.2	160	.2	.4	.5
100,000	62,301	62,141	62.3	62.1	160	.2	.3	.4
250,000	190,475	190,315	76.2	76.0	160	.1	.1	.2
500,000	471,925	471,765	79.1	79.1	160	.1	.1	.2
750,000	806,666	806,506	81.3	81.3	160	.1	.1	.2
1,000,000	1,122,725	1,122,565	83.0	83.0	160	.1	.1	.2
\$1,000,000	838,840	838,690	83.9	83.9	160	.1	.1	.2

¹ Internal Revenue Code, as amended by the Revenue Act of 1945

² Assumes tax on one spouse has income.

³ Less than 0.05 percent.

TABLE 9

TABLE 1.—Comparison of amounts and effective rates of individual income tax under present law¹ and under the House bill (H. R. 4790)

SINGLE PERSON 1—NO DEPENDENTS

Net income before personal exemption	Amounts of tax		Effective rates		Decrease in amount of tax compared with present law	Decrease in effective rates compared with present law	Tax decrease as a percentage of present liability	Decrease as a percentage of net after-tax liability
	Present law	House bill (H. R. 4790)	Present law	House bill (H. R. 4790)				
\$600	\$19	0	3.2	0	\$19	3.2	100.0	3.3
800	27	\$27	7.1	3.3	36	3.8	52.0	4.1
1,000	65	65	9.5	5.3	42	4.2	44.0	4.6
\$1,200	133	80	11.1	6.7	53	4.4	39.8	5.0
1,400	190	120	12.7	8.0	70	4.7	37.0	5.4
1,600	285	213	14.3	10.6	72	3.7	25.3	4.2
1,800	380	280	16.2	11.6	99	3.6	24.0	4.3
2,000	485	371	16.2	12.4	114	3.8	23.5	4.5
2,200	604	33	17.3	13.5	165	3.8	22.4	4.7
2,400	722	77	18.4	14.5	191	3.9	21.1	4.8
2,600	1,109	650	19.5	15.6	219	3.7	18.7	4.6
2,800	1,442	1,442	21.6	18.0	277	3.5	16.1	4.4
3,000	2,347	2,063	23.6	20.0	344	3.5	14.7	4.3
3,200	4,270	3,723	28.5	24.8	547	3.7	12.8	5.1
3,400	6,845	5,856	32.2	29.3	700	3.9	11.0	6.0
3,600	9,362	8,296	37.4	33.2	1,068	3.2	11.4	6.8
3,800	12,137	10,482	45.0	40.0	1,655	3.3	10.6	10.7
4,000	15,177	13,060	50.3	45.0	2,117	3.0	10.3	14.3
4,200	18,477	15,960	56.0	52.0	2,517	2.8	10.2	17.0
4,400	22,032	18,832	62.5	57.0	3,200	2.7	10.1	20.0
4,600	25,837	21,737	69.0	63.0	4,100	2.6	10.1	23.2
4,800	29,882	24,832	76.0	70.0	5,050	2.5	10.1	26.5
5,000	34,167	27,832	83.0	77.0	6,335	2.4	10.1	29.7
5,200	38,692	30,832	89.0	83.0	7,860	2.3	10.0	32.7
5,400	43,457	33,832	95.0	89.0	9,625	2.2	10.0	35.7
5,600	48,472	36,832	100.0	95.0	11,640	2.1	10.0	38.7
5,800	53,737	39,832	100.0	100.0	13,905	2.0	10.0	41.7
6,000	59,252	42,832	100.0	100.0	16,420	1.9	10.0	44.7
6,200	64,917	45,832	100.0	100.0	19,085	1.8	10.0	47.7
6,400	70,732	48,832	100.0	100.0	21,900	1.7	10.0	50.7
6,600	76,697	51,832	100.0	100.0	24,865	1.6	10.0	53.7
6,800	82,812	54,832	100.0	100.0	27,980	1.5	10.0	56.7
7,000	89,077	57,832	100.0	100.0	31,245	1.4	10.0	59.7
7,200	95,492	60,832	100.0	100.0	34,660	1.3	10.0	62.7
7,400	102,057	63,832	100.0	100.0	38,225	1.2	10.0	65.7
7,600	108,772	66,832	100.0	100.0	41,940	1.1	10.0	68.7
7,800	115,637	69,832	100.0	100.0	45,805	1.0	10.0	71.7
8,000	122,652	72,832	100.0	100.0	49,820	0.9	10.0	74.7
8,200	129,817	75,832	100.0	100.0	53,985	0.8	10.0	77.7
8,400	137,132	78,832	100.0	100.0	58,300	0.7	10.0	80.7
8,600	144,597	81,832	100.0	100.0	62,765	0.6	10.0	83.7
8,800	152,212	84,832	100.0	100.0	67,380	0.5	10.0	86.7
9,000	160,077	87,832	100.0	100.0	72,145	0.4	10.0	89.7
9,200	168,092	90,832	100.0	100.0	77,060	0.3	10.0	92.7
9,400	176,257	93,832	100.0	100.0	82,125	0.2	10.0	95.7
9,600	184,572	96,832	100.0	100.0	87,340	0.1	10.0	98.7
9,800	193,037	99,832	100.0	100.0	92,705	0.1	10.0	101.7
10,000	201,652	102,832	100.0	100.0	98,220	0.0	10.0	104.7

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.

² Single persons obtain no benefit under the income-splitting provision of H. R. 4790.

³ Assumes taxpayer is not entitled to the special exemption for either the aged or the blind.

TABLE 2.—Comparison of amounts and effective rates of individual income tax under present law¹ and under the House bill (H. R. 4790)

MARRIED PERSONS 1—NO DEPENDENTS

Net Income before personal exemption	Amounts of tax		Effective rates		Increase in amounts of tax compared with present law	Decrease in effective rates compared with present law	Tax increase as a percentage of present liability	Decrease in percentage of net income after present tax liability
	Present law	House bill (H. R. 4790)	Present law	House bill (H. R. 4790)				
\$1,200	38	0	3.2	0	\$38	3.2	100.0	3.3
\$1,600	95	40	6.3	2.7	55	3.6	58.0	3.9
2,000	190	106	9.5	5.3	84	4.2	44.0	4.0
\$2,800	28	173	11.4	6.9	112	4.5	39.3	5.1
\$3,000		239	12.7	8.0	141	4.7	37.0	5.4
\$4,000	18	426	14.7	10.6	163	4.1	27.7	4.8
\$5,000	798	678	16.0	11.6	220	4.4	27.6	5.2
6,000	1,045	742	17.4	12.4	303	5.0	29.0	6.1
7,000	1,577	1,076	19.7	13.5	501	6.2	31.8	7.8
8,000	2,185	1,458	21.9	14.6	730	7.4	33.4	9.3
\$15,000	4,047	2,328	27.0	17.5	1,419	9.5	35.1	13.0
\$20,000	6,391	4,109	32.0	20.0	2,382	12.0	37.3	17.5
\$25,000	9,082	5,580	36.3	22.4	3,493	13.9	38.5	21.9
\$30,000	24,795	16,492	49.5	33.2	8,203	16.4	33.1	32.5
\$75,000	43,092	30,013	57.5	40.0	13,079	17.5	30.4	41.0
\$100,000	63,128	44,964	63.1	45.0	18,164	18.1	28.8	49.3
\$250,000	191,340	152,092	76.5	60.8	39,248	15.7	20.5	66.9
\$500,000	277,790	228,604	79.4	65.33	49,185	14.1	17.7	68.1
\$1,000,000	407,465	344,874	81.5	69.0	62,591	12.5	15.4	67.6
\$50,000	623,590	339,350	83.1	71.9	84,203	11.2	13.5	66.6
\$1,000,000	839,715	733,899	84.0	73.4	105,816	10.6	12.6	66.0

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.
² Assumes only 1 spouse has income.
³ Assumes taxpayer is not entitled to the special exemption for either the aged or the blind.

TABLE 3.—Comparison of amounts and effective rates of individual income tax under present law¹ and under the House bill (H. R. 4790)

MARRIED PERSON 1—2 DEPENDENTS

Net Income before personal exemption	Amounts of tax		Effective rates		Increase in amounts of tax with present law	Decrease in effective rates compared with present law	Tax increase as a percentage of present liability	Decrease in percentage of net income after present tax liability
	Present law	House bill (H. R. 4790)	Present law	House bill (H. R. 4790)				
\$2,400	\$76	0	3.2	0	\$76	3.2	100.0	3.3
3,000	160	0	5.3	0	160	5.3	58.0	3.9
4,000	380	21.3	9.5	5.3	167	4.2	44.0	4.6
5,000	598	386	11.8	7.7	203	4.1	34.5	4.6
6,000	798	547	13.3	9.1	251	4.2	31.4	4.8
8,000	1,292	876	16.2	10.9	416	5.33	32.2	6.2
10,000	1,862	1,210	18.6	12.1	652	6.5	35.0	8.0
\$15,000	3,639	2,323	24.3	15.5	1,316	8.8	36.2	11.6
\$20,000	5,800	3,657	29.5	18.3	2,133	11.2	37.9	15.8
30,000	8,522	5,200	34.1	20.8	3,322	13.3	37.0	20.2
40,000	11,140	7,980	48.2	32.0	3,160	16.2	33.7	31.4
50,000	14,323	10,316	56.4	39.1	4,007	17.3	30.7	39.7
100,000	22,301	14,228	62.3	44.2	8,073	18.1	20.6	47.9
\$250,000	100,475	151,179	76.2	60.5	39,296	15.7	20.0	56.0
\$500,000	276,925	227,681	79.1	65.1	49,244	14.0	17.8	67.4
\$500,000	406,600	343,940	81.3	68.8	62,660	12.5	15.4	67.1
750,000	22,725	538,453	83.0	71.8	84,272	11.2	13.5	66.2
1,000,000	34,850	732,965	83.9	73.3	105,885	10.6	12.6	65.7

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.
² Assumes only 1 spouse has income.
³ Assumes taxpayer is not entitled to the special exemption for either the aged or the blind.

REDUCTION OF INDIVIDUAL INCOME TAXES

EXHIBIT 10

Estimated number of taxable income recipients and their total individual income tax under present laws and under \$40 per capita tax credit, distributed by net income classes, in calendar year 1948 (assuming personal income of \$200,000,000,000)

(Number of income recipients in thousands; money amounts in millions)

Net income class in thousands of dollars	Number of income recipients			Total tax \$			
	Taxable under present law	Taxable under the \$40 per capita tax credit	Made nontaxable by the \$40 per capita tax credit	Under present law	Under the \$40 per capita tax credit	Decrease under the \$40 per capita tax credit	under the capital tax
				Amount	Amount	Amount	Percent- age distribution
Under 1.....	5,832.7	3,090.2	2,742.5	\$252.1	\$79.0	\$172.5	5.4
to 2.....	20,000.0	15,700.7	4,299.3	3,030.0	1,000.0	2,030.0	33.3
to 3.....	15,096.3	12,801.6	2,294.8	4,182.0	1,000.0	3,182.0	18.0
	5,790.1	5,393.0	397.1	2,489.7	1,111.7	1,378.0	7.0
	2,612.9	2,447.0	165.9	1,661.6	1,311.6	350.0	
Under 5.....	49,775.2	39,432.5	10,342.7	11,524.8	8,436.6	2,988.2	63.0
5 to 10.....	10,000.0	10,000.0	0	1,000.0	1,000.0	0	0
10 to 25.....	10,000.0	10,000.0	0	2,000.0	2,000.0	0	0
25 to 50.....	10,000.0	10,000.0	0	4,000.0	4,000.0	0	0
50 to 100.....	10,000.0	10,000.0	0	8,000.0	8,000.0	0	0
100 to 250.....	10,000.0	10,000.0	0	16,000.0	16,000.0	0	0
250 to 500.....	10,000.0	10,000.0	0	32,000.0	32,000.0	0	0
500 to 1,000.....	10,000.0	10,000.0	0	64,000.0	64,000.0	0	0
1,000 and over.....	10,000.0	10,000.0	0	128,000.0	128,000.0	0	0
Grand over.....	2,284.1	2,284.1	0	9,718.1	9,493.1	225.0	7.0
Grand total.....	62,089.4	41,716.6	20,372.8	21,242.9	18,029.7	3,213.2	100.0

1. Internal Revenue Code, as amended by the Revenue Act of 1948, includes for net tax, and alternative tax on net long-term capital gains, less than \$5 thousand and 10 percent.

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

EXHIBIT 11.—Estimated number of taxable income recipients and their total individual income tax under present law and under the House bill (H. R. 4700), distributed by net income classes, in calendar year 1948 (assuming personal income of \$200,000,000,000)

(Number of income recipients in thousands; money amounts in millions)

(in thousands of dollars)	Number of income recipients			Total tax \$			
	Under present law	Under the House bill	Under the House bill	Under present law	Under the House bill	Under the House bill	Under the House bill
4 to 5.....	2,612.9	2,447.0	165.9	1,661.6	1,311.6	350.0	
Under 5.....	49,775.2	39,432.5	10,342.7	11,524.8	8,436.6	2,988.2	63.0
5 to 10.....	1,498.2	1,498.2	0	1,498.2	1,498.2	0	0

EXHIBIT 11.—*Estimated number of taxable income recipients and their total individual income tax under present law and under the House bill (H. R. 4790), distributed by net income classes, in calendaryear 1948 (assuming personal income of \$200,000,000,000)—Continued*

(Number of income recipients in thousands; money amounts in millions)

Net income class (in thousands of dollars)	Number of income recipients			Total tax †		Decrease under House bill (H. R. 4790)	
	Taxable under present law	Taxable under bill (H. R. 4790)	Made nontax- able under House bill (H. R. 4790)	Under present law	Under House bill (H. R. 4790)	Amount	Percent- age dis- tribution
Up to 25.....	308.1	608.1	.....	2,441.1	1,825.4	638.7	10.2
25 to 50.....	149.5	149.6	.....	2,144.2	1,097.8	446.4	7.1
50 to 100.....	61.4	51.4	.....	1,878.0	1,654.2	324.7	2.2
100 to 250.....	10.3	10.3	.....	990.0	844.3	135.7	2.2
250 to 500.....	1.3	1.3	.....	321.8	286.6	35.2	.6
500 to 1,000.....	.3	.3	.....	177.7	160.3	17.4	.3
1,000 and over.....	1	.1	.....	124.9	113.6	11.3	.2
5 and over.....	2,284.	2,284.1	.....	9,718.1	7,615.2	2,102.9	33.7
Grand total.....	62,059.4	46,774.9	6,284.5	21,242.9	14,997.9	6,245.0	100.0

† Internal Revenue Code, as amended by the Revenue Act of 1948.

‡ Includes normal tax, surtax and alternative tax on net long-term capital gains.

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

EXHIBIT 12

Estimated revenue lost from each individual income tax provision of the House bill (H. R. 4790), distributed by net income class, in calendar year 1948 (assuming personal income of \$200,000,000,000)

[In millions of dollars]

Tax decrease from each individual income tax provision of House bill (H. R. 4790)¹

Net income class (in thousands of dollars)	Total decrease from House bill (H. R. 4790)	Increase in the exemption	Additional exemption for persons over 65	Special provision for blind	Allow married couples to file their income	Increase in the deduction	Reductions of tentative normal tax and surtax							
							Total from all	33 1/2 per cent	28 1/2 per cent	\$201.60 plus 1 per cent over				
Under 1.....	148.9	-	-	-	-	-	-	-	-	-	-	-	-	
1 to 2.....	1,269.5	96.5	8.1	0.1	-	44.3	44.3	2.1	-	-	-	-	-	
2 to 3.....	1,443.6	522.1	70.8	1	-	676.5	349.2	27.1	0.2	-	-	-	-	
3 to 4.....	821.6	553.9	73.0	1	0.5	816.1	289.6	39.6	486.9	-	-	-	-	
4 to 5.....	459	264.3	68.4	-	3	483.5	18.7	71.5	293.3	-	-	-	-	
Under 5.....	459	131.2	18.0	-	1	292.8	32.2	-	183.3	-	-	-	-	
5 to 10.....	4,142.1	1,467.9	238.3	-	20.3	313.2	4.0	473.4	963.7	-	-	-	42.1	
10 to 20.....	403.5	87.9	19.2	(?)	69.6	248.7	2.4	4.0	17.5	-	-	-	124	
20 to 30.....	638.7	3.3	4	(?)	296.1	259.0	-	-	2.9	-	-	-	233.1	
30 to 40.....	446.4	20.11	2.2	(?)	224.4	197.4	-	-	2.3	-	-	-	197.4	
40 to 50.....	324.7	8.4	.9	(?)	142.2	172.8	-	-	4.4	-	-	-	172.8	
50 to 100.....	135.7	1.8	.2	(?)	4.3	88.3	-	-	(?)	-	-	-	17.8	
100 to 250.....	35.2	.2	(?)	(?)	4.69	29.4	-	-	(?)	-	-	-	9.3	
250 to 500.....	17.4	.1	(?)	(?)	9	16.4	-	-	-	-	-	-	29.4	
500 to 1,000.....	11.3	-	-	-	-	11.2	-	-	-	-	-	-	16.4	
1,000 and over.....	11.3	-	-	-	-	11.2	-	-	-	-	-	-	11.2	
5 and over.....	2,109.0	176.8	30.0	-	783.2	91.7	-	-	-	-	-	-	894.4	
						1,021.2								894.4

¹The provisions are estimated consecutively, each individual loss depending on the cumulative effect of preceding provisions.

²Less than \$50,000

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

INDIVIDUAL INCOME

EXHIBIT 13

Comparison of combined normal tax and surtax rates under present law¹ and under the House bill H. R. 4790)

Burtax net income		Combined normal tax and surtax rates			Percent decrease (-) or increase (+) in rates compared with present law
Exceeding—	Not exceeding—	Present law	House bill (H. R. 4790)	Percent decrease (-) or increase (+) in rates compared with present law	Percent decrease (-) or increase (+) in rates compared with present law
		Tentative rates	Rate after 5 percent reduction		
		Percent	Percent	Percent	Percent
	\$1,000			13.3000	-5.700
\$1,000	\$1,400	20	1 0	20.0000	+1.0000
\$1,400	\$2,000		1	15.200	-3.800
\$2,000	\$4,000			16.7200	-4.180
\$4,000	\$6,000	26	24.70	22.230	-2.470
\$6,000	\$8,000	30	28.50	25.650	-2.850
\$8,000	\$10,000	31	32.30	29.070	-3.230
\$10,000	\$12,000	38	36.10	32.490	-3.610
\$12,000	\$14,000	43	40.85	36.765	-4.085
\$14,000	\$16,000	47	44.655	40.185	-4.45
\$16,000	\$18,000	50	47.50	42.750	-4.750
\$18,000	\$20,000	53	50.35	45.315	-5.035
\$20,000	\$22,000	56	53.20	47.880	-5.320
\$22,000	\$24,000	59	56.05	50.445	-5.605
\$24,000	\$26,000	62	58.90	53.010	-5.890
\$26,000	\$28,000	65	61.75	55.575	-6.175
\$28,000	\$30,000	6	65.55	58.905	-6.65
\$30,000	\$32,000	72	68.40	61.500	-6.840
\$32,000	\$34,000	75	71.25	64.125	-7.125
\$34,000	\$36,000	78	74.10	66.690	-7.410
\$36,000	\$38,000	81	76.95	69.255	-7.695
\$38,000	\$40,000	84	79.80	71.820	-7.980
\$40,000	\$42,000	87	82.65	74.385	-8.265
\$42,000	\$44,000	89	84.55	76.995	-8.455
\$44,000	\$46,000	90	85.60	78.950	-8.550
\$46,000	\$48,000	91	86.45	77.805	-8.645

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.
² Designates notch area under the House bill. The exact upper limit of the notch area is \$1,395.83.
³ Tax is subject to the following maximum effective rate limitations: under present law, 85.5 percent; under the House bill, 77 percent.

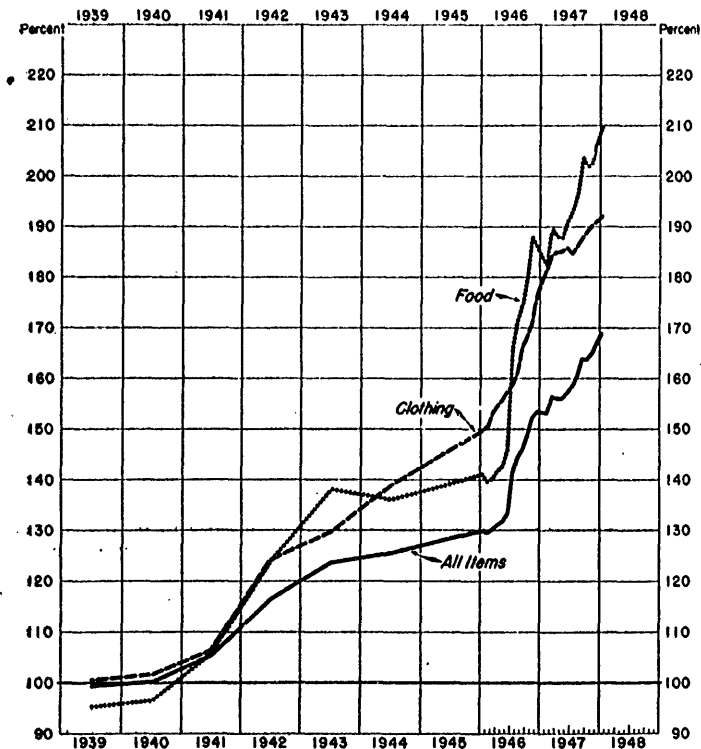
EXHIBIT 14

Estimated number of taxable income recipients distributed by the various percentage reductions provided under the House bill (H. R. 4790), in calendar year 1948, assuming personal income of \$200,000,000,000

Surtax income	Tentative normal tax and surtax	Reductions of effective normal tax and surtax	Reduction of effective present law tax	Number of actual taxable recipients
0 to \$1,000	0 to \$200.00	33.5 percent	30 percent	23,700,000
\$1,000 to \$1,395.83	\$200.00 to \$279.17	46.7	30 to 20 percent	7,700,000
\$1,395.83 to \$4,000	\$279.17 to \$840	24 percent	20 percent	12,500,000
\$4,000 and over	\$840 and over	\$201.60 plus 14.5 percent of excess over \$840.	\$159.60 plus 10 percent of excess over \$798.	1,700,000
Total				45,800,000

¹ Internal Revenue Code, as amended by the Revenue Act of 1945.

Chart 1
CONSUMERS' PRICE INDEX 1939 TO DATE
 All Items, Food and Clothing
 1935-'39=100



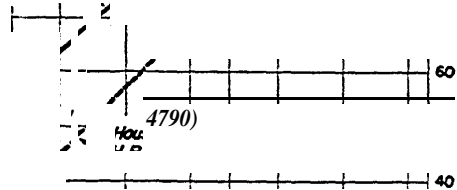
Source Bureau of Labor Statistics consumers' price index for moderate-income families in large cities

Chart 2

EFFECTIVE RATES OF INDIVIDUAL INCOME TAX

Present **Law** and House Bill (H.R. 4790)

Married Person. No **Dependents**



THE INDIVIDUAL INCOME TAX

APPENDIX

TABLE A.—Estimated number of taxable and nontaxable income recipients, their income and individual income tax under present law in calendar year 1948, assuming personal income of \$200,000,000

	Number of incom e recipients (thousands)	AMOUNT income in million dollars	Total tax (millions)
Total, all income recipients.....	71,678	\$147,632	\$21,243
Nontaxable income recipients.....	19,619	18,020	—
Taxable income recipients.....	52,059	132,012	21,243
Subject to surtax.....	62,059	4,89,108	18,000
Subject to normal tax.....	52,059	80,183	2,453
Subject to alternative tax.....	—	4,373	—

- 1 Internal Revenue Code, as amended by the Revenue Act of 1945.
 2 Net Income before exemptions.
 3 The number of persons paying normal tax is estimated to be less than 500 smaller than the number paying surtax.
 4 Surtax net income.
 5 Normal tax net income.
 6 Net long-term capital gains subject to alternative tax.

TABLE B.—Estimated number of taxable income recipients under present law,¹ their surtax net income and combined normal tax and surtax, distributed by surtax net income brackets, in calendar year 1948, assuming personal income of \$200,000,000

(Number of income recipients in thousands; money amounts in millions)

Surtax net income brackets (in thou- sands of dollars)	Taxable income recipi- ents cumulated from highest bracket		Surtax net income in bracket		Combined normal tax and surtax in bracket	
	Number	Percent	Amount	Percent	Amount	Percent
Under.....	52,050.4	100.00	\$38,410.4	67.88	\$11,105.1	52.72
2 to 4.....	11,190.6	21.50	10,409.6	12.19	2,194.3	10.42
4 to 6.....	2,352.3	4.52	3,175.1	3.60	784.0	3.70
6 to 8.....	1,250.3	2.42	2,048.5	2.38	583.2	2.77
8 to 10.....	920.9	1.78	1,592.1	1.85	514.2	2.44
10 to 12.....	725.6	1.39	1,224.2	1.42	441.9	2.10
12 to 14.....	560.4	1.09	991.9	1.16	406.4	1.93
14 to 16.....	462.5	.89	822.2	.95	307.1	1.74
16 to 18.....	385.5	.74	600.8	.80	328.1	1.66
18 to 20.....	322.5	.62	583.5	.68	293.8	1.40
20 to 22.....	275.3	.53	502.2	.58	257.1	1.27
22 to 24.....	237.8	.46	425.9	.49	462.0	2.20
24 to 26.....	176.4	.34	340.4	1.09	553.9	2.63
26 to 28.....	120.1	.23	665.0	.77	410.6	1.95
28 to 30.....	92.0	.18	602.8	.68	329.6	1.57
30 to 32.....	73.8	.14	394.4	.46	269.7	1.28
32 to 34.....	60.5	.12	474.4	.55	338.0	1.61
34 to 36.....	40.2	.08	326.4	.38	241.8	1.15
36 to 38.....	—	—	227.2	.28	174.8	.83
38 to 40.....	19.8	.04	165.8	.19	152.3	.63
40 to 42.....	14.3	.03	118.9	.14	88.3	.47
42 to 44.....	10.7	.02	342.7	.40	289.7	1.38
44 to 46.....	4.2	.01	142.8	.17	122.1	.58
46 to 48.....	—	—	401.4	.47	347.0	1.65
48 to 50.....	—	—	—	—	—	—
50 to 52.....	—	—	—	—	—	—
52 to 54.....	—	—	—	—	—	—
54 to 56.....	—	—	—	—	—	—
56 to 58.....	—	—	—	—	—	—
58 to 60.....	—	—	—	—	—	—
60 to 70.....	—	—	—	—	—	—
70 to 80.....	—	—	—	—	—	—
80 to 100.....	—	—	—	—	—	—
100 to 150.....	—	—	—	—	—	—
150 to 200.....	—	—	—	—	—	—
Over 200.....	2.2	()	—	—	—	—
Grand total.....	—	—	\$6,108.4	4.100.00	21,056.2	100.00

- 1 Internal Revenue Code, as amended by the Revenue Act of 1945.
 2 Normal tax and surtax were obtained separately by applying the appropriate rates to normal tax and surtax net income. Since normal tax net income is somewhat less than surtax net income, these amounts will differ slightly from the result obtained by applying the combined rates to surtax net income.
 3 Less than 0.005 percent.
 4 Excludes amounts subject to the alternative tax.

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

REDUCTION OF INDIVIDUAL INCOME TAXES

TABLE C.—Estimated number of taxable income recipients under present law,¹ their net income before exemptions, surtax net income and total tax, distributed by net income classes, in calendar-year 1948 (assuming personal income of \$200,000,000,000)

[Number of income recipients in thousands; money amounts in millions]

Net income classes (in thousands of dollars)	Taxable income recipients		Net income before exemptions ²		Surtax net income		Total tax ³	
	Number	Percentage distribution	Amount	Percentage distribution	Amount	Percentage distribution	Amount	Percentage distribution
Under 1.....	5,832.7	11.2	\$4,228.1	3.2	\$1,327.2		\$252.1	1.2
1 to 2.....	20,383.1	39.6	31,050.8	23.4	14,008.3		3,039.6	14.3
2 to 3.....	15,096.3 ⁴	29.0	37,603.0	28.1	21,917.2		4,162.0	19.7
3 to 4.....	5,760.1	11.0	19,758.2	14.9	12,849.5		2,489.4	11.7
4 to.....	2,512.9	4.8	1,102.9	8.4	7,908.0		1,561.0	7.4
Under 5.....	49,778.2	95.6	103,643.1	78.0	60,030.2	69.7	71,624.8	4.3
5 to 10.....	493.2	2.8	9,457.3	7.1	7,609.0	8.8	1,626.5	7.7
11 to 25.....	608.1	1.2	9,035.0	0.8	8,290.8	9.7	2,464.1	11.6
25 to 50.....	149.5	.3	5,081.8	3.8	4,830.2	5.06	2,144.2	10.1
50 to 100.....	51.4	.1	3,422.5	2.6	3,286.0	3.8	1,878.9	8.8
100 to 250.....	10.3	.0	1,458.5	1.1	1,350.9	1.6	980.0	4.6
250 to 500.....	1.3	.0	428.6	.3	380.5	.4	321.8	1.5
500 to 1,000.....	.1	.0	226.3	.2	199.5	.2	177.7	.8
1,000 and over.....			158.0	.1	131.2	.2	124.9	.6
Over 5.....	2,284.1	4.4	20,800.0	22.0	20,078.2	30.3	9,718.1	46.0
Grand total....	52,059.4	100.0	132,911.7	100.0	86,106.4	100.0	21,242.9	100.0

¹ Internal Revenue Code, as amended by the Revenue Act of 1915.

² Includes amounts subject to the alternative tax.

³ Includes normal tax, surtax, and alternative tax on net long-term capital gains.

⁴ Less than 0.05 percent.

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

TABLE D.—Number of taxable individual and fiduciary returns, tax and net income, 1913-46, and estimated for 1947-48

Year	Number of returns	Tax	Net Income
1913		\$28,254,000	(1)
1914		\$41,046,000	(2)
1915		\$67,944,000	(3)
1916	362,970	173,387,000	\$4,137,233,000
1917	2,707,224	785,281,000	10,592,687,000
1918	3,397,863.3	1,127,792,000	13,897,776,000
1919	4,231,181	1,269,630,000	17,691,620,000
1920	5,518,210	1,075,054,000	20,228,850,000
1921	3,589,985	719,387,000	13,469,685,000
1922	3,681,249	861,057,000	15,043,514,000
1923	4,270,121	960,666,000	17,497,383,000
1924	4,489,608	704,265,000	19,468,724,000
1925	2,501,166	734,655,000	17,471,219,000
1926	2,470,990	732,475,000	17,412,633,000
1927	2,440,941	830,639,000	18,090,000,000
1928	2,523,063	1,164,254,000	21,031,634,000
1929	458,049	1,001,038,000	20,493,491,000
1930	2,037,645	476,715,000	13,692,584,000
1931	1,825,544	246,127,000	9,297,018,000
1932	1,936,095	329,962,000	7,919,588,000
1933	1,747,740	374,120,000	7,372,660,000
1934	1,795,920	511,400,000	8,343,558,000
1935	2,110,890	657,439,000	10,034,106,000
1936	2,561,108	1,214,017,000	14,218,854,000
1937	3,371,443	1,141,569,000	15,284,162,000
1938	3,048,645	765,833,000	12,671,537,000
1939	3,150,297	928,904,000	15,803,945,000
1940	7,046,619	1,496,403,000	23,558,030,000
1941	17,587,471	3,907,951,000	45,402,884,000
1942	27,718,334	4,926,712,000	67,060,862,000

See footnotes at end of table.

TABLE D.—Number of taxable individual and fiduciary returns, tax and net income, 1913-46, and estimated for 1947-48—Continued

Year	Number of	Tax	Td.
1943.....	40,337,293	14,590,018,000	98,150,189,000
1944.....	42,446,837	16,347,479,000 ^o	(?)
1945 (preliminary).....	42,764,062	17,228,983,000	(?)
1946.....	42,840,638	17,400,000,000	(?)
1947.....	44,000,000 ^o	20,600,000,000	(?)
.....	46,000,000	21,242,870,000	132,911,677,0

^o Not available. The total number of taxable and nontaxable returns filed were as follows: 1913, 357,598; 1944, 357,516; and 1915, 336,652.

¹ Receipts (including fines, penalties, additional assessments, etc.) for the fiscal year ended June 30 immediately following as shown in annual reports of the Commissioner of Internal Revenue.

² Not available.

³ Includes war excess profits taxes of \$101,249,781 on individuals and \$103,887,061 on partnerships. Tax base for taxable returns with net incomes of \$2,000 and over. There were 1,501,518 taxable returns with net incomes of \$2,000 and over, for which the tax amounted to \$675,244,450.

⁴ Amount after the 25-percent reduction provided by sec. 1201 (a), Revenue Act of 1921.

⁵ Excludes addition to liability under the Current Tax Payment Act of 1943 amounting to \$2,555,894,000.

⁶ Obtained from collectors' monthly report to Commissioner of returns filed.

⁷ Estimated.

Source: Data for 1916-45 from Statistics of Income.

Senator **BARKLEY**. You read that with as much fervor as if it had been a product of your own brain.

The **CHAIRMAN**. But without conviction, Senator.

I do not suppose comments are in order, because the Secretary is not here. Later, if any member of the committee wishes the Secretary to come before the committee, we will be glad to call him.

Mr. Webb is our next witness. Mr. Webb, will you state your full name and your business for the record?

STATEMENT OF JAMES E. WEBB, DIRECTOR OF THE BUREAU OF THE BUDGET

Mr. **WEBB**. James E. Webb, Director of the Bureau of the Budget.

The **CHAIRMAN**. Will you proceed with your statement, Mr. Webb.

Mr. **WEBB**. Mr. Chairman and members of the committee, you have asked me to appear before the committee today to discuss Federal expenditure. It will be my purpose to discuss the budget estimates for 1949 and to indicate some of the trends which may be reasonably expected for 1950.

Before taking up the figures for 1949, I should like to point out, with respect to the fiscal year 1948, that I can add little to the figures presented in the 1949 budget. Those figures indicate 37.7 billion dollars of expenditures during the current fiscal year, ending June 30, 1948. Since the budget was submitted in January there have been a number of developments which will cause variations in the estimates, and, without doubt, other modifications will appear during the next few months. None of these variations is material enough to warrant any revision of the 1948 expenditure total at this time.

With respect to the fiscal year 1949, I should like to summarize the policies and assumptions on which the budget was based. The general policy, expressed in the President's instructions to the Departments and agencies for the preparation of 1949 appropriation requests, was to hold programs for that year at or below the 1948 level. Exceptions were made only where activities no longer could be deferred.

New expenditures were limited to those essential for the discharge of **international** responsibilities or to meet urgent needs at home.

Further, the expenditure estimates for 1949 were based on the assumption that prices and employment would remain at about the level of last fall. Rises in prices inevitably will mean increased costs for most of the things the Government buys. Likewise, a decrease in agricultural prices or an increase in unemployment would mean that expenditures **would rise** for such mandatory programs as farm price support, veterans' unemployment allowances, and public assistance.

In his budget message, the **resident** stressed that fact that the size of the 1949 budget was determined in large part by heavy expenditures resulting from the war and its aftermath. I should like to quote two sentences from that message:

The plain fact is that our budget must remain high until we have met our international responsibility and can see the way clear to a peaceful and prosperous world. Prudence demands that we plan our national finances in full recognition of this fact.

Present indications are that this Nation will have uncertain world conditions for an extended period. Practically everything we do to meet these conditions will cost money and be reflected in the budget. These facts have added significance when Federal expenditures are projected beyond the fiscal year 1949.

Unless world conditions change drastically for the better, the Federal budget in 1950 will undoubtedly be large. That fact cannot be ignored in any consideration of legislation on taxes. We Americans have always been optimistic. The hard facts of international life do not, in my opinion, justify the degree of optimism which would make it possible to forecast a 1950 budget materially lower than that for 1949.

In the preparation of the 1949 budget the President reduced departmental requests for appropriations by over \$7,000,000,000. Further reductions in appropriations are being sought by the Congress. At the same time, however, individual members, as representatives of their constituents, are being asked to seek funds for projects which are considered of great local importance. For example, in connection with that part of the 1949 budget covering flood control and river and harbor work performed by the Army engineers, over 100 Members of Congress presented statements to the House Appropriations Committee to support specific projects, many of which had been omitted from the budget under the rigid criteria applied. I mention this example, not in criticism but to emphasize what I believe is our common experience that tile pressure for Federal expenditure shows no sign of diminishing.

Expenditures in the budget for the fiscal year 1949 were estimated at 39.7 billion dollars. Of this amount, \$34,000,000,000 will be expended under existing laws. The balance of 5.7 billion dollars will be needed to pay obligations incurred under new legislation recommended by the President.

The recently authorized increased subsistence allowances for veterans are estimated to result in an increase in expenditures of approximately \$150,000,000 in 1949. However offsetting savings may be realized if the Congress should enact legislation to curtail avocational and leisure-time training.

When the budget was submitted in January, expenditures under new international aid programs other than the European recovery program were estimated at \$140,000,000. As the needs have developed, it now appears that expenditures may amount to as much as \$300,000,000, largely because of increases in the estimates for the Chinese and Greek-Turkish aid programs. Similarly, the President's recommendations on housing forwarded to Congress last week will require somewhat higher expenditures in 1949 than were estimated in January. Such changes as these will necessitate offsetting economies in other programs if the 1949 expenditure total is not to exceed the January estimate of 39.7 billion dollars.

Perhaps the simplest method of showing expenditure trends is to relate 1949 figures by programs to the corresponding figures for the current fiscal year. For this purpose I submit a comparative table based on the figures as printed in the budget document in January. Brief notes explain the reasons for major changes.

(The table is as follows:)

TABLE 1.- Federal budget expenditures—Comparison of estimated Federal Budget expenditures, fiscal years 1948 and 1949, as shown in 1949 Budget document

[In millions of dollars]				
Function and program	fiscal 1948	1949 fisc. 1949	Change	Explanation
National Defense:				
Air, Army, and naval defense:				
Present programs.....	10,321	10,148	-173	Decrease in military pay and maintenance due to lower average strength; increase in aviation and Reserve components.
Proposed legislation.....	39	179	+140	Primarily for public works; also drill pay for reserve components.
Universal training (proposed legislation).		400	+400	First-year cost to obtain supplies and to prepare for trainees.
Terminal leave, stock-piling, and other.		297	-88	Decreases in terminal leave and other war liquidation; increase for stock-piling.
Total, national defense	10,746		+279	
International affairs and finances.				
Reconstruction and stabilization:				
Greek-Turkish aid (act of 1947):				
Other.....	278	119	-159	Completion of presently authorized program.
Proposed legislation: European recovery				Exhaustion of United Kingdom loan in 1948 and decline in Export-Import loans.
Other aid legislation		400		Expenditures from anticipated supplemental appropriation for
Foreign relief:				Includes aid to China and other prospective programs.
Interim aid (act of 1947):				
Army (occupied countries).....	272	168	-210	Completion of program.
Other.....	272	60	-212	Increase in Army relief for occupied areas, due to assumption of British dollar cost for full year for bilateral area.
Other international activities, including Philippine rehabilitation:				Liquidation of UNRRA program.
Present programs.....	287	378	+88	Primarily increase in Philippine war damage payments.
Proposed legislation	35		+31	Increased payments under loan for PN construction of headquarters; expansion of international information program; and restoration of benefits to Philippine veterans.
Total, international affairs and finances.....			-800	
			+1,476	

TABLE I.—Federal budget expenditures—Comparison of estimated Federal Budget expenditures, fiscal years 1948 and 1949, as shown in 1949 Budget document—Continued

Function and program	[In millions of dollars]		Change	Explanation
	1948 fiscal year	1949 fiscal year		
Veterans' services and benefits:				
Readjustment benefits and insurance.	3,505	2,655	-850	Declining number of claimants for education and unemployment benefits.
Pensions	2,055	2,105	+50	Increase in number on rolls; decline in subsistence for disabled students.
Hospital construction and medical care.	647	1,027	+380	Acceleration in construction; continuing rise in patient load.
General administration and other...	424	316	-108	Reduced work load in administering Servicemen's Readjustment Act; wind-up of FWA education facility program.
Total, veterans' services and benefits.	6,632			
Social welfare, health, and security:				
Retirement and dependency insurance.	767		-182	1948 abnormally high because part of 1947 transfer to Railroad Retirement Board trust fund delayed to 1948.
Assistance to the aged and other special groups:				
Present programs (Federal Security Agency and Agriculture).	820	894	+74	Upward trend in both benefit levels and caseload in FSA public assistance programs.
Proposed legislation			+100	Broadening and improving FSA public assistance program.
Public health, unemployment, crime control, and other:				
Present programs		434		Acceleration of Federal-aid hospital construction program and other necessary programs.
Proposed legislation		1		Initial planning and organization costs for national health insurance program and related health grants.
Total, social welfare, health, and security.	1,960	28		
Housing and community facilities:				
Present programs:				
RFC mortgage purchases	70			Termination of authority to purchase VA-guaranteed home mortgage loans.
Veterans' reuse housing	69	7		Completion of construction.
Other	-26	-11		Mainly declining repayments of HCLC loans.
Proposed legislation for long-range housing and local public works planning.		0		Long-range housing assistance program and advances States and municipalities for planning local public works.
Total, housing and community facilities.	113	38	-75	
Education and general research:				
Present education and general-purpose research programs.	77	91	+14	Largely increased matching requirements for vocational educational grants under George Varden Act approved Aug. 1, 1946.
Proposed new aid for education and research.		296	+296	Largely grants to States for elementary and secondary education; also National Science Foundation.
Total, education and general research.	77	387	+310	

TABLE 1. Federal budget expenditures—Comparison of estimated federal Budget expenditures, fiscal years 1948 and 1949, as shown in 1949 Budget document—Continued

(In millions of dollar)

Function and program	1948 fiscal year	1949 fiscal year	Change	Explanation
Agriculture and agricultural resources:				
<i>rice support, supply, and purchase (Commodity Credit Corporation):</i>				
Present programs	-247	12		Nonrecurring receipts in 1948 from sale of urban sugar purchased in 1947.
Proposed legislation		-50		Possible effect of revision in parity formula and price support level.
All other loan, aid, and development programs.	8600	9422		Net effect of increases in agricultural loan and investment programs and decrease in conservation payments and other aids.
Total, agriculture and agricultural resources.	6144	9004	+282	
Natural resources not primarily agricultural:				
Atomic energy programs	4765	6747	+1982	Mainly construction of improved, new facilities.
Flood control (Corps of Engineers, civil).	314	449	+135	Increased requirements for economic rate of construction on projects now underway.
Reclamation programs (Interior)...	183	2688	+2505	Largely increased construction rate for reclamation projects now started.
All other	2077	235	-1842	Increases for several resource and conservation programs, principally Bonneville Power Administration and other Interior Department activities.
Total, natural resources	1,1707	1,626	+447	
Transportation and communication:				
Promotion of the merchant marine...	3283	225	-3058	Reduced Government operations through sale and charter of vessels to private operators.
Other present programs	1,234	1,403	+169	Principally increase in construction rate on Federal-aid highways and airports, and on river and harbor projects.
Proposed legislation		18	+18	Ocean weather stations and other items.
Total, transportation and communication	1,5633	1,646	+83	
Finance, commerce, and industry:				
War Damage insurance	230		-230	Nonrecurring payments to miscellaneous receipts and insurance companies of profits in connection with dissolution of War Damage Corporation.
All other:				
Present programs	117	73	-44	Liquidation of war activities; decline in RFC loan business.
Proposed legislation	24	117	+93	Rent control and other anti-inflation activities; censuses.
Total, finance, commerce, and industry.	372	196	-176	
Labor:				
Present programs	97	110	+13	State, public employment offices and administration of Taft-Hartley Act.
Proposed legislation		7	+7	Grants to States for industrial safety; also establishment of fair employment practices organization.
Total, labor	97	117	+20	

TABLE I.—Federal budget expenditures—Comparison of estimated Federal Budget expenditures, fiscal years 1948 and 1949, as shown in 1949 Budget document—Continued

[In millions of dollars]

Function and program	1948 fiscal year	1949 fiscal year	Change
general government:			
surplus property disposal, foreign and domestic:			
Present programs			
Proposed legislation.....			
RFC payment of interest to miscellaneous receipts.			
All other:			
Present programs	Oil	974	+30
Proposed legislation.....		3	+3
Total, general government..	<u>1,473</u>	<u>1,157</u>	-316
interest on the public debt		5,250	+60
Refunds of receipts.....	2,049	1,991	-58
Reserve for contingencies	120	200	+80
Total, budget expenditures	<u><u>37,794</u></u>	<u><u>36,220</u></u>	<u>+1,574</u>
Present programs including contingencies)	37,070	33,934	-3,136
Proposed legislation.....	6	1,735	+1,729

NOTE.—Figures will not necessarily add to totals because of rounding.

Mr. **WEBB**. Before leaving the 1949 figures, attention should be called to a special problem which particularly interested the members of the committee who served on the Joint Committee on the Legislative Budget last year. A surprisingly large part of 1949 expenditures are required because of fixed commitments which are not subject to adjustment by the President in preparing his budget and not subject to curtailment by the Congress without changing the basic laws governing many of our major programs.

After provision has been made to meet our national defense and international responsibilities, which together are estimated to require over \$18,000,000,000 of expenditures, the bulk of the remaining \$21,600,000,000 in the budget represents charges which are not controllable within a given year.

The cost of veterans' pensions, tax refunds, and interest on the public debt amount to more than \$9,300,000,000. Grants to State and local governments account for an additional \$2,300,000,000 much of which is determined by the amount of funds spent by the States. Readjustment benefits for veterans add another \$2,600,000,000 an amount largely determined by the number of persons eligible under the law and by general economic conditions. The natural-resources program, includ-

ing atomic energy, flood control, and reclamation, amount to over \$1,800,000,000 and can be cut back substantially only if we are willing to accept great economic loss. Many other continuing programs would be difficult to change on short notice.

Preliminary consideration of some of the problems to be faced in preparing the budget for 1950 already has begun. While it would be premature to specify the total magnitude or the amount of any major item in the 1950 budget, certain trends are apparent.

Expenditures for European recovery and other proposed new international aid programs will probably reach their peak of about \$6,000,000,000 in the fiscal year 1950. Deliveries of goods for these programs will not reach full volume until the latter part of the fiscal year 1949. Since payments customarily lag behind deliveries the expenditure peak will occur in 1950. Reductions in expenditures under the existing programs for relief abroad will be substantial, but we cannot reasonably expect that such savings will prevent an increase over 1949 in total expenditures for international programs. Under present plans' however, total payments for international programs may be expected to decline in 1951 and 1952.

Expenditures for national defense may also have to increase in 1950 even to maintain our present military strength. As wartime stocks of military supplies and equipment are exhausted or become obsolete, increased procurement is required. Stock piling of strategic and critical materials has been held back for more than 3 years to prevent interference with reconversion. An increase in expenditures in this area will undoubtedly carry a high priority in 1950 and subsequent years. Major realignments to bring about a more efficient utilization of funds in the defense program are now in process. It is hoped that the success of these measures will permit expenditures for national defense under existing programs to be held at somewhere near the present level.

Inauguration of universal training in 1949 will involve increased expenditures in 1950. The President feels that this measure is an essential foundation for the maintenance of an adequate military strength and will, in time, reduce military costs.

New legislation recommended by the President in the domestic field also points toward increases in the 1950 budget for certain programs on which the 1949 budget provides only first-year outlays. The new national health program and the broadening of public-assistance grants, as well as the stream-pollution-abatement program, would cause a continuing rise in expenditures in 1950 and later years in the category social welfare, health, and security.

The revised housing program outlined by the President in his message to Congress last week will involve a more rapid rise in expenditures than previously contemplated. The proposed aids to urban development under the new bill would be financed by one-time payments, rather than by annual contributions spread over a period of 45 years as proposed in earlier bills. In addition, purchases of insured mortgages may require substantial budget expenditures in the first few years, followed by receipts in later years when the mortgages are sold or repaid.

Expenditures for agricultural programs are expected to run considerably higher in 1950 than in 1949, largely because of the proposed

higher level of conservation payments to farmers for the 1949 crop year.

The veterans' program is likely to show a major reduction in 1950. Expenditures for readjustment benefits under the Servicemen's Readjustment Act will decline as veterans exhaust their benefits. General administrative expenditures should also drop. On the other hand, pensions and outlays for hospital and medical care are expected to increase steadily. Assuming that no major new benefits are enacted into law, the decline in expenditures for the veterans' program will continue in 1951 and 1952.

If taxable income continues stable, tax refunds will decline little, if at all. Interest payments on the public debt will not decline appreciably in the next few years.

Expenditures for public works in the fiscal year 1949 are estimated to reach a total of about \$2,800,000,000, and will probably reach \$3,000,000,000 in 1950. They are estimated at about the \$3,000,000,000 level in 1951 and 1952. Whether this figure represents a maximum level will depend upon whether pressures for more new programs can be held back until some of the present ones are completed. In this connection, one problem will be the increasing demand to reinstate the program for the construction of Federal buildings throughout the country. If the \$3,000,000,000 level is not to be exceeded, both the Congress and the executive branch must exercise strict controls over public-works programs.

Finally, I should like to mention one further problem which has a direct bearing on expenditures, although not in the manner frequently suggested. Some advocates of economy in the Federal Government have advanced the thesis that the surest way to bring about substantial reduction in expenditures is to cut the Federal pay roll. I have tried to show that a very large proportion of our Federal budget represents fixed commitments.

Dismissal of personnel will not change those commitments. Actually, Federal civilian employment, although still around the 2,000,000 mark, represents an expenditure of about \$6,000,000,000. Nearly two-thirds of the employees and of the money involved are accounted for by the Post Office Department and civilian employees of the National Military Establishment. If the pay rolls of all the remaining Federal agencies were cut in half, a step that would make it impossible to carry out the laws and programs authorized by Congress, expenditures would be reduced about \$1,000,000,000.

To sum up, the large budgets which disturb us all are a reflection of our national responsibilities in a world full of hazards and uncertainties. From present indications these responsibilities will require large budget expenditures in the immediate years to come. If this general outlook is correct, we face a common task of applying the principles of sound and prudent fiscal policy in budgetary matters.

THE CHAIRMAN: Mr. Webb, what part of the 1949 estimates of expenditures represent what, in your department, you call firm estimates?

MR. WEBB. Senator, they represent firm estimates all of them, as of the time they were made. Now, as I have indicated to you, there are changes that take place on a vast and complex undertaking like the

operating programs of the Federal Government, and many matters do change almost from month to month, and we follow them very closely.

Perhaps I could illustrate by saying that projections made a year ahead as to the number of veterans who will enter college, for instance, have to be revised the nearer you get to the beginning of the college year, when you begin to get actual figures.

The CHAIRMAN. As I understand it, in your Department you refer to a firm estimate of expenditures as one where you are able to make such studies of it that your estimate is closely accurate, is that correct?

Mr. WEBB. Well **Senator**, it is very hard for me to draw a line and say that those on this side of the line are firm and those on the other are not. We are estimating 2 years ahead what the payments will be under construction contracts. That depends on the amount of progress that the contractor can make. We make the best estimates that we can, but you do have to judge within the area of whether you will have a good construction season or a poor one, so it is very difficult to say one thing is firm and another is not.

The CHAIRMAN. I shall not press you on the use of the words. Is it not correct that many of your estimates do not rest upon complete and thorough examination by the Bureau of the Budget, as distinguished from those where you are in position to make such studies as warrant your saying that the amount of these expenditures will have to be made?

Mr. WEBB. I would say that every item in the President's budget recommendations reflects the best knowledge and information available in the executive branch as of the time it is made. That knowledge is different for different programs.

The CHAIRMAN. Of course, let us assume that that is correct. That still begs the question which I am asking you. For example, let us take the proposed expenditures for foreign affairs, and I am not making any argument in asking the question as to whether they should be increased or held as proposed or reduced. What is the source of your information as to the correctness of those figures?

Mr. WEBB. We start with the work of the various departments of the Government. We studied the work of the Harriman committee, the Krug committee, the Council of Economic Advisers, even some of the work performed in the legislative branch by the Herter committee, and others, and we proceed to work with the departments who have to submit and justify their estimates to Congress, to consider all of the information available to them, the recommendations that they have made based on that information. We thoroughly examine to see whether or not those recommendations are sufficiently firm or whether we will suggest to the President that he implement them by his own recommendation.

The CHAIRMAN. Now, let us test whether the recommendations in foreign affairs are sufficiently firm. When was the Marshall plan first announced?

Mr. WEBB. My recollection is that it was last June that General Marshall first made his statement at Cambridge. I am not certain of that month, but that is my recollection.

The CHAIRMAN. When did the 16 nations meet in Europe to consider the Marshall plan?

Mr. WEBB. It was shortly thereafter, within the next month or 6 weeks, as I recall it.

The CHAIRMAN. How long after that did they come up with the figures which were submitted to the Government of the United States?

Mr. WEBB. I do not recall that exact date. If you could refresh my memory, I would give it to you.

The CHAIRMAN. I would say sometime in the fall of last year, was it not?

Senator BARKLEY. The conference met in Paris in September, and they made a report around the latter part of October, I think.

The CHAIRMAN. And thereafter, with the information in the hands of our own Government, what did we do in the nature of studying the projects of the program as we study, for example, long in advance of authorization or appropriation of a reclamation project or a flood-control project, so as to arrive at figures which could be considered as reasonably

Mr. WEBB. The studies that were made had to do, first of all, with the valuation of the estimates submitted by the European nations; second, with our ability to meet those needs. Those were really deficits of goods or money.

The CHAIRMAN. Now, is it not clear to you, with your knowledge of how we go at it in figuring estimates on, let us say, reclamation and flood control projects, that you could not possibly come up with anything resembling firm estimates for ERP? I am not intimating that they are too low or that they are incorrect or that they should not be higher, but it is not perfectly clear to you that under the way that we reach so-called firm estimates that it would be utterly impossible for this vast project, having been initiated last June, to come here and now have the status of something that can be counted on with definiteness and accuracy?

Mr. WEBB. Senator, my opinion is that one of the finest cooperative undertakings that has ever been engaged in, in this country, was carried forward in those intervening months and has resulted in the recommendations to the Congress. I think they are splendidly done.

The CHAIRMAN. Let us agree on that; I hold that I have made it very clear that I am not attacking what you have said. I am just talking about whether within the time that I have mentioned, it would be possible to come up with firm estimates of the type that we use when we figure on our reclamation or flood control projects.

Mr. WEBB. They are certainly not as firm a calculation as the interest on the national debt, but they are as firm as they can be made at this time.

The CHAIRMAN. Let us assume that that is correct. Are they what would be, use any word you please, what you would call an estimate which under experience will not be deviated from substantially up or down?

Mr. WEBB. My opinion is that the first year of operation under the European recovery program will deviate little from the present estimates. Now, in the second and third year, we have made projections based on careful studies of previous programs such as UNRRA, the post-UNRRA aid, our experience in the occupied countries and so forth. I feel that many things can happen over a period of the next

12 to 24 months, and I do not fool as firm about the second and third year, but on the first year. I feel that they are completely realistic.

The CHAIRMAN. Do you think that the 16 countries that met in July, between that time and the time that they submitted their estimates to this country, had time to send out field parties, project act. projects, estimate the cost of them and come up with what might be termed an estimate comparable to those that we use in connection with our reclamation and flood-control projects.

Mr. WEBB. No, sir, I would not say the information would be com-

The CHAIRMAN. All I am driving at, as to that vast item we are acting on, moved by let us call it intelligent and patriotic judgment, is there not necessarily large room for variation up or down, under the program as projected?

Mr. WEBB. I do not think that there is a large area. I would add the word "informed" judgment, also.

The CHAIRMAN. I have no objection to that, if by informed judgment you exclude that type of field work, that type of thorough groundwork investigation of which we are habituated to in connection with our large projects here. Would you exclude the type of work from your statement?

Mr. WEBB. It me indicate on fact, and that is that when you are operating within time limits such as my salary here today, with the necessity of including some statement for you with respect to the now housing recommendations and bearing in mind that expenditures are an entirely different thing from appropriation requests and authorizations, my estimate to you on the domestic housing program is not based on careful, detailed schedules; it is based on broad experience with that kind of program.

The CHAIRMAN. Tell me another field which you have just mentioned, you do not have what might be called a firm estimate of expenditures, is that correct?

Mr. WEBB. It is certainly firm within certain limitations. I would say for the first year there are relatively narrow possibilities of deviation.

The CHAIRMAN. If that basic work has not been done, out of which you call calculate the cost of a house or calculate the cost of a dam, how call you say that it is firm within narrow deviations?

Mr. WEBB. I say that partly because in our study of the presentations of expenditures under the European recovery program we definitely had the objective to examine as closely, as we could fit in reporting data and not to include items that had any serious doubt about them. We did eliminate items there.

The CHAIRMAN. Did the supporting data include tile plans and specifications for specific projects?

Mr. WEBB. In some cases they are specific projects. Generally, they are rather broad plans involving the economy of 16 nations and deficits of payments.

The CHAIRMAN. Would you not say that that allows wide field for adjustment under experience, up or down?

Mr. WEBB. I would certainly say that a thorough study of the work of these committees that I have indicated might permit different people to arrive at different opinions. You asked my opinion. My opinion is that it is good work and that the estimates are realistic.

The CHAIRMAN. I will agree with you in the objective of the work. All that I am asking you is whether the Bureau of the Budget or whether you consider that this is an inviolable figure or, due to the nature of its presentation, it might be subject to large adjustments.

Mr. WEBB. I consider if this country adopts the objectives of the program and desires to implement them, the expenditure will be not less than those indicated in the budget.

The CHAIRMAN. Of course, the expenditures might not be less than those indicated in the budget, but they might not have necessary relation to the projects which are in mind. I have no doubt that when we are through, the expenditures will be those indicated in the budget, but I am trying to find out whether, and so far I have not succeeded, you believe that in that field out of the necessities from which the estimates were prepared there necessarily must be a larger or a large area of leeway up or down.

Mr. WEBB. The trouble I have, Senator, is that we have taken out most of the leeway downward in presenting a program which is down to a very firm basis.

The CHAIRMAN. I suggest that you did it on the basis of generality; I suggest that when the Nation first made their estimates, they were grossly swollen from the American viewpoint and that Mr. Clayton went over and told them to stop their nonsense and bring the figures down to something within the range that might be acceptable in the United States; and that that reduction was made on the basis of generality and not in a reconsideration of the details of specific projects. Am I right or wrong?

Mr. WEBB. I think that you are right. I might say this, Senator. I have with me today the head of our estimates division who gave detailed consideration to the material submitted to us, who can tell you the procedure that we used in following those, if you wish to hear the factors that were involved.

The CHAIRMAN. I may want to question you on that. I do not now wish to make a debate on the bill that is coming up before the Senate today. I have been very careful to make it clear that personally I favored the objectives. I hope that I have made it very clear that I am not making any suggestion here that the amount should be greater or less. I am simply trying to drive at the way in which the figures were accomplished, leading to the end point which I am making, that there are large areas in this budget of yours that are adjustable.

Senator BARKLEY. In that connection, I was getting at the variables in an estimated budgetary expenditure under the European program. If Congress should fail to adopt it the \$4,000,000,000 plus would be eliminated.

The question of individual projects will be determined by the Administrator. He will pass upon those things after the expenditure has been authorized and in the very nature of the case the Budget Bureau could not anticipate a decision by the Administrator of the European recovery plan as to any given project, I imagine.

But based upon the theory that Congress will authorize the program, and based upon the theory that the Administrator will make due and diligent and prompt effort to carry it out, in view of all the conditions, you figured, with all those who were assisting in arriving

at a reasonable amount to be included in the budget that this amount was as nearly correct as could be arrived at in view of all these circumstances. Is that true?

Mr. WEBB. Yes, Senator; and these plans are devoted toward implementing an objective for an authorizing bill. Not only is a great deal of information being submitted to Congress for the purpose of supporting the authorization, but immediately following that there will be as detailed information as is available with respect to the actual appropriation itself and a great deal of information about specific projects will be included. But the general plan cannot be confined to specific projects that are foreseen over a 4-year period.

Senator BARKLEY. The Administrator might turn down a project which would eliminate the expenditure for that, and he might approve another one which would completely absorb that expenditure, so that you have to strike what is as nearly a fair and general average as possible in order to have any budgetary recommendations at all on it.

Mr. WEBB. That is right.

Senator GEORGE. May I ask the Director if he will furnish for the record at this point, in connection with his testimony, the exact amounts included in the President's budget for all foreign aid, not only European aid but aid in the occupied areas as well as China, if any, Greece and Turkey, if any?

Mr. WEBB. Yes, sir.

Senator GEORGE. In other words, every item that is included in the President's budget.

Senator BYRD. May I ask that that be furnished in the names of the recipient countries; how much each country gets?

Mr. WEBB. We will give you the best information that is available at this time.

Senator BYRD. Furnishing information on where the money finally goes.

Mr. WEBB. As nearly as we can. Some of the programs, like the far eastern programs, are not completely developed.

(The information referred to follows:)

of Budget estimates programs (including revisions of January budget where noted)

[In millions of dollars]

Program	Fiscal 10			Fiscal 1040 ¹		
	Appropriations	Expenditures	Unobligated balance	Appropriations	Expenditures	Unobligated balance
A. Relief assistance to war-damaged countries	332	332	272			60
Foreign (interim) aid	246	246	315			16
Occupied areas	1,090	1,090	998	1,250	1,250	0
Export-Import Bank			30			0
British Lend-Lease		701	701			0
Greek-Turkish aid	400	400	275			11
Philippine rehabilitation	42	44	43			
Philippine war damage	70		51	121	123	
International Refugee Organization	71	71	71	71	71	71
UN A	2	2	201			
Subtotal	2,8		4,722	265	1,437	2,347

See footnotes at end of table.

TABLE II.—Summary of Budget estimates for foreign-aid programs (including revisions of January budget where noted)—Continued

(In millions of dollars)

Program	Fiscal 1948			Fiscal 1949		
	Approp.	Rependitures	Unobligated balance	Approp.	Rependitures	Unobligated balance
B. Proposed:						
European recovery program	6,890	1,000	500	5,800	4,000	
Other foreign aid:						
Aid to China	570	145	65	425	405	
Greek-Turkish aid	20	4	2	275	151	
Aid to Trieste				16	13	
Latin American military cooperation	10	4	2	6	8	
Far eastern reconstruction	275	50	25	225	175	
Subtotal	7,95	103	594	6,747	4,747	
Grand total	10,497	5,448	5,310	6,773	4,437	8,23

1 Bank's amounts not kept on usual obligation basis.
 2 Includes \$20,000,000 of obligations under contract and other obligation authority.
 3 For country break-down of European recovery program, see Tables IV and V.
 4 Figures under "Other foreign aid" are revised from January budget.
 5 Estimated that about \$50,000,000 will be encumbered for procurement, but not actually obligated due to Army allotment system.
 6 Preliminary estimates submitted by Department of the Army, not yet reviewed.

Senator LUCAS. May I inquire whether that saving is included in the Committee on Foreign Relations?

Mr. WEBB. I do not know what the latest information furnished by General Marshall is. My understanding is that he gave the Committee on Foreign Relations a letter a month or so—maybe 3 weeks ago in which he mentioned the amount, \$70,000,000 for China and stated that the other programs would raise that figure to about \$1,000,000,000.

Now, since that time he has made a statement on the Greek-Turkish aid. The estimate has not yet been submitted to Congress as a final recommendation to the Congress, specifying the detailed amounts, but I believe it will come shortly.

Now, as to the details with respect to other than the Greek-Turkish aid, no conclusion has finally been reached about that. An authorizing bill is now before Congress.

Is that what you wanted, Senator?

Senator LUCAS. Yes.

The CHAIRMAN. Senator Connally?

Senator CONNALLY. So far as the amounts that are to be allocated to the various countries, there has been a good deal, according to my view, of confusion and uncertainty about that in the published lists. And in those published lists some of those countries it is anticipated will not receive anything. They are in the plan to try to coordinate and organize the economy of western Europe, but some of those countries will probably not need any aid, will not be extended any aid to themselves, but they cooperate and assist in the rehabilitation program for that area.

So I do not know whether you will be able to give a list of how much is going to this country and how much is going to that country. Of course, that is going to be largely determined by the Administrator when he gets his funds and gets his organization and takes a general

view of the whole situation and sees where the most urgent needs are at the moment, and works out his program gradually over a period of time.

Mr. WEBB. I understood Senator George wanted the amounts over and above the European recovery program, that he was not asking that this extend to the details of the European recovery program.

Senator GEORGE. I do not want any speculation. I simply want what is included by way of foreign aid in the President's budget. Now, that is not speculative at all. You have it in there somewhere.

Mr. WEBB. Yes, sir.

Senator GEORGE. I would like to have it tabulated and put in the record here. That to include not merely the aid to the 16 European countries, or China, but also any expenditures in the occupied areas in Germany and Japan and Korea.

Senator BYRD. Does that contemplate furnishing a break-down?

Senator GEORGE. No break-down at all. Simply the items that are in the budget is what I wanted to get at.

Senator BYRD. I want to suggest a modification, that that also include full information as to what countries get how much.

Mr. WEBB. Senator, rather complete information has been supplied in connection with the European recovery program. You do not desire us to break down that at this time? You are thinking of the additional items over and above the amount recommended to you?

Senator BYRD. Not at all. I am thinking of the bill now before the Senate. I want to know how much each country is to receive under that bill.

Mr. WEBB. We will do the best we can.

(See table II, p. 58; table IV, p. 64; and table V, p. 66.)

Senator BYRD. I assume you have that, because you have an aggregate amount right down to the dollar, that you say cannot be reduced—I mean others have said that in the Government-without-terrific injury. That being the case there must be a break-down somewhere. It is obtainable as to what these countries get, the specific amounts they are to receive.

Mr. WEBB. I think I understand what you want. We will give you the best information we have. I thought Senator George's question was arriving at the total amount which the budget expenditure would require.

Senator BYRD. That would be another request.

If you can, I would like you to furnish that as soon as possible.

(See table II, p. 58; table IV, p. 64; and table V, p. 66.)

The CHAIRMAN. Senator Brewster?

Senator BREWSTER. In addition to what Senator Byrd asked for, I think the figures regarding countries are very significant and important. But I think also the question regarding projects, such as shipping and other items which are included in it, are also very significant.

I will say that following the chairman's suggestion this started, as I recall, originally at \$27,000,000,000; was then reduced to \$22,000,000,000-

Senator BARKLEY. Started at \$29,000,000,000.

Senator BREWSTER. Was then cut to 17 billion dollars and then the 17-billion-dollar figure was wiped out and we got down to the 6.8 billion dollars and then the 5.3 billion dollars.

The allocation among countries is one item. The allocation among economic reconstruction and economic relief, the two items—relief and rehabilitation—I assume must also have been taken into account by your studies in order to determine the totals; were they not?

Mr. WEBB, Yes, sir. All the information that we had.
(See table V, p. 66.)

Senator BREWSTER. I have read all the releases, the Harriman report and the other reports and the State Department report and it seems very difficult to determine what part is coming from this country and what from offshore countries of the Western Hemisphere, and I think the latest tabulation on which you base your figures would be extremely important in appraising the point which the chairman makes as to their dependability.

Mr. WEBB. Thank you, sir. I will put that in the record.
(The information requested is as follows:)

TABLE I *ated foreign-aid expenditures, by type and source of purchase*
(In millions of dollars)

Program by type of purchase	Fiscal year 1948, source of purchase				Fiscal year 1949, source of purchase			
	United States	Other Western Hemisphere	Other	Total	United States	Other Western Hemisphere	Other	Total
I. EXISTING								
1. Relief assistance to war devastated countries.....	266			272	57		3	60
Food.....	148			164	37			37
Fertilizer.....				1				(1)
Agricultural supplies.....				1	1			1
Fuel.....	191			28	8		3	11
Medical supplies.....	5			5	1			1
Shipping.....	303			30	8			8
Transfer to International children's Emergency fund.....	40			40				
Administrative expenses.....	8				1			
Not distributed.....				5				
2. Foreign (interim) aid.....	299	17	66	382				
Food.....	172	3		180	76	2	2	80
Fertilizer.....	3			3	1	1	1	3
Agricultural supplies.....	3			3	1			1
Fuel.....	22			85	20		12	32
Medical supplies.....	4		14	4	6			6
Textiles.....	13			133	6			6
Shipping.....	69			69	31			31
Not distributed.....	16			15	2			2
3. Occupied area.....					691	(1)	369	1,250
Food.....	425			570	600	(1)	248	748
Agricultural supplies and fertilizer.....	42	(1)		84	52	(1)	60	112
Petroleum.....	31	(1)		55	54	(1)	37	91
Medical supplies.....	14	(1)		16	16			16
Shipping.....	151	(1)		161	181		9	190
Administration.....	62	(1)		61	78	(1)	2	80
Not distributed.....	40	(1)		60	91		4	133
4. Export-Import Bank.....	736			736				
Machinery and vehicles.....	401			401	325			325
Shipping.....	151			151	0			0
Cotton.....	97			97	60			60
Raw cotton.....	89			77	40			40
Metals and manufactures.....	17			110	60			60
Industrial raw materials.....	2			2	0			0
Food.....				11				11
Not distributed.....				11				11
Repayments and other adjustments.....				-202	-150			-352

See footnotes at end of table.

TABLE III.—Estimated foreign-aid expenditures, by type and source of purchase—
 Continued

Program by type of purchase	Fiscal year 1948, source of purchase				Fiscal year 1949, source of purchase			
	United States	Other Western Hemisphere	Other	Total	United States	Other Western Hemisphere	Other	Total
I. EXISTING—CON.								
5. British loan.....	(1)	1	1	1,700	.....	.....	.....	.....
6. Aid to Greece and Turkey	20	111	55	275	119	.....	.....	111
Military supplies and training.....	152	.....	38	190	82	.....	.....	82
Economic rehabilitation.....	57	111	17	85	37	.....	.....	37
7. Philippine rehabilitation.....	5	.....	38	43	7	.....	1	54
Public works.....	a	.....	2	30	.....	.....	45	51
Public services and training.....	.....	.....	11	13	1	.....	6	7
8. Philippine war damage (payment of claims).....	.....	.....	1	51	.....	.....	123	123
9. International Refugee Organization.....	.....	.....	.....	.....	.....	.....	.....	.....
Cash contribution.....	.....	.....	.....	.....	.....	.....	.....	.....
Food (purchased by Army).....	.....	.....	.....	62	.....	.....	.....	71
10. UNRRA.....	.....	.....	.....	.....	.....	.....	.....	.....
Clothing, textiles.....	26	.....	.....	26	.....	.....	.....	.....
Food.....	85	.....	.....	85	.....	.....	.....	.....
Agricultural rehabilitation items.....	4	.....	.....	14	.....	.....	.....	.....
Industrial rehabilitation items.....	22	.....	.....	22	.....	.....	.....	.....
Medical and sanitation supplies.....	.....	.....	.....	.....	.....	.....	.....	.....
Surplus property transfers.....	144	.....	.....	14	.....	.....	.....	.....
Shipping.....	36	.....	.....	36	.....	.....	.....	.....
Subtotal existing grants.....	.....	.....	.....	.....	.....	.....	.....	.....
II. PROPOSED								
1. European recovery program .....	.....	.....	.....	500	.....	.....	.....	4,000

Commodity totals shown below are in terms of estimated shipments for period Apr. 1, 1948, through June 30, 1949, expressed in prices as of July 1947. To get to estimated expenditure total for entire program, the over-all adjustments shown below were made for average price increases, shipping savings, enter in pipeline of shipments financed from pre-EHP sources, and time lag between shipments and payment. These adjustments have not been broken down by commodities, so that expenditure estimates for each commodity are not available at this time. Commodities for western Germany to be financed from the appropriation "Government and relief in occupied areas" are included in the detail below, but adjustment is made in the total.

	United States	Other Western Hemisphere	Other	Total
Food.....	1,310	.....	.....	3,18
Tobacco.....	236	.....	.....	236
Cotton.....	.....	.....	.....	.....
Fertilizer.....	.....	.....	.....	.....
Agricultural machinery.....	.....	.....	.....	.....
Coal.....	79	.....	.....	176
Mining machinery.....	.....	.....	.....	.....
Petroleum products.....	322	.....	.....	322
Timber.....	94	37	.....	132
Iron and steel.....	151	9	.....	160

See footnotes at end of table.

TABLE III — Estimated foreign-aid expenditures, by type and source of purchase—Continued

Program by type of purchase	[In millions of dollars]							
	United States	Other Western Hemisphere	Other		Other			Total
II. PROPOSED—CON.								
1. Eur program—Con.								
Freight cars		9						
Industrial equipment					2			
Not distributed		702						
Shipping								
Total	3,878	2,691						7,060
Minus Government and relief in occupied areas	(1)	(1)			(1)			822
Total shipments at July 1947 prices								1,238.8
Price increase since July 1947		(1)			(1)			70.0
Total Savings on shipping								
Time lag between shipment and payment								
Entering pipe line of shipments forward from pre-ERP sources								
Rounding					-600			-2,230
Net expenditures								4,600
	Fiscal year 1948, source of purchase				Fiscal year 1949, source of purchase			
	United States	Other Western Hemisphere	Other	Total	United States	Other Western Hemisphere	Other	Total
2. Aid to China	44		21	65	248		157	405
Food					22		79	107
Tobacco	4		4	8				22
Cotton	30			30	105			105
Fertilizer			16	16	8			24
Petroleum	4			4	20		60	84
Industrial supplies and equipment	4			4	62			62
Other								
3. Greek-Turkish aid: Military supplies and training					110		40	150
4. Aid to Trieste	2			2	12			14
Food					8			8
Fuel					3			3
Other								1
5. Latin-American military cooperation: Military supplies and training	2			2	8			8
6. Far Eastern reconstruction				25	20			175
Raw materials	4	(1)		3	30	(1)	60	93
Machinery and parts		(1)		(1)	5			10
Reminished goods	1			1			1	6
Miscellaneous supplies	2			2	17			19
Vehicles and parts	1			1	11			12
Shipping	3			3				82
Subtotal, proposed programs								4,751
Grand total								7,098

1 Less than \$500,000.
 2 Included under other.
 3 Division of purchase by area not available.

Senator **BARKLEY**. Would it really make any difference as far as the budget figure is concerned whether it comes from this country or an off-shore country, if we have to pay for it?

Mr. WEBB. If you add those last words, except that Senator Byrd has indicated a desire to see the internal structure.

Senator **BARKLEY**. I understand. But inasmuch as we are obligating ourselves to purchase these things, whether in this country or some other country, the budget figure would be the same. There might be a variation according to the price we would have to pay in different countries, but you have to overestimate the over-all.

Mr. WEBB. That is right.

Senator **BREWSTER**. I want to make clear to the Senator from Kentucky that I contemplate we may get a little more participation from our comrades in the Western Hemisphere and that is why I think it is of possible significance.

Senator **BARKLEY**. I hope so. So far as our own legislation and program is concerned, it contemplates the payment.

Senator **BREWSTER**. That, I gather, is to be determined.

Senator **BYRD**. Mr. Chairman, I would like to make clear my question. As I understand, the total program is \$17,000,000,000. the European recovery program?

Mr. WEBB. That is the total estimate on which the plan was based.

Senator **BYRD**. My inquiry was directed at the distribution of that entire program, not only the expenditure in this fiscal year, or the next fiscal year.

Mr. WEBB. We will give you the best information that we have. (The information requested is as follows:)

TABLE IV.—Break-down of total ERP program by countries and fiscal years

[The following table shows the estimated composition of the full 4½-year ERP program by countries and fiscal years. It has not been possible to estimate with exactness how much of the total needs of each country will be met by sources other than ERP appropriation (International Bank and private credits, unexpended existing credits, assistance from other Western Hemisphere countries, etc.). The total expected from such sources cannot therefore, be allocated by countries but is shown as an over-all deduction from the total requirements for all countries.]

ESTIMATED SURPLUS (+) OR DEFICIT (-), OF ERP COUNTRIES ON CURRENT ACCOUNT WITH TOTAL WESTERN HEMISPHERE, BY COUNTRY AND BY PERIOD, 1948-52

[In millions of dollars]

Country	April to June 1948	1948-49	Total, April 1948 to 1949	1949-50	1950-51 ¹	1951-52 ²	Grand total
1. Austria.....	-43	-151	-194	-200	-167	-152	-713
2. Belgium-Luxemburg.....	-100	-439	-539	-372	-311	-246	-1,474
3. Belgian Dependencies.....	+6	+21	+27	+11	+7	+11	+74
4. Denmark.....	-30	-162	-192	-14	-128	-119	-582
5. Ireland.....	-30	-121	-151	-122	-117	-117	-497
6. France.....	-910	-1,090	-1,400	-778	-493	-233	-2,924
7. French Dependencies.....	-29	-134	-163	-11	-90	-60	-414
8. Greece.....	-37	-157	-194	-115	-67	-77	-473
9. Iceland.....	-2	-10	-12	-5	-	-8	-38
10. Italy.....	-197	-780	-977	-760	-616	-542	-2,913
11. Netherlands.....	-154	-650	-804	-616	-683	-490	-2,512
12. Dutch Dependencies.....	-6	-4	-10	+33	+30	+60	+76
13. Norway.....	-14	-76	-90	-68	-49	-27	-234
14. Portugal.....	-19	-64	-83	-38	-32	-24	-168
15. Portuguese Dependencies.....	1	+3	+4	+2	+8	+0	+18
16. Sweden.....	1	-65	-64	-13	-60	+78	-234
17. Switzerland.....	1	+20	+21	+230	-	+22	+274
18. Turkey.....	+7	-5	+2	-10	+0	-4	-10
19. United Kingdom.....	-567	-1,023	-2,400	-1,61	-1,341	-1,265	-6,655

TABLE IV.—Break-down of total ERP program by countries and fiscal years—Con.

ESTIMATED SURPLUS (+) OR DEFICIT (-) OF ERP COUNTRIES ON CURRENT ACCOUNT WITH TOTAL WESTERN HEMISPHERE, BY COUNTRY AND BY PERIOD, 1948-52—Continued

(In millions of dollars)

Country	April to June 1948	1948-49	Total, April to June 1948	1949-50	1950-51	1951-52	Grand total
20. British dependencies				+284			+284
21. Germany:							
Allied zone	-105	-750	-855	-70	-400		-2,490
22. French zone	-1	-60	-61	-78	-74	-77	-310
23. Saar	-2	-6	-8	-14	-14	-14	-50
24. Combined balance on current account (at July 1, 1948)			-8,062	-5,234	-4,126		-17,422
25. Adjustment for savings in shipping	+100	+50	+150	+134	+86	+30	+400
Total adjusted for savings on shipping	-1,650	-6,303	-7,952	-5,200	-4,040	-3,293	-20,495
27. Adjustment for higher price							-1,600
28. Adjusted balance (upper level)	-1,774	-6,753	-8,527	-5,370	-4,379	-3,564	-22,066
29. Adjustment for lower prices and lower freight rates	-115	-420	-535	+142	+578	+916	+1,071
30. Adjusted balance (lower level)	-1,774	-6,753	-8,527	-5,1	-3,462	-2,377	-19,424
31. Range of adjusted estimates (in billions of dollars) ..	to	to	to	to	to	to	to
	1.774	6.753	8.527	5.1	4.4	3.6	22.1

The last item is an estimate of the net deficits of the participating countries with the Western Hemisphere. The following further adjustments are necessary to arrive at an estimate of United States appropriated funds needed:

(In millions of dollars)

	April to June 1948	1949	1950	1951	1952	Total
Range of net deficits (item 31 above)	1.774	6.753	8.527	5.1	4.4	22.1
Add German Allied zone needs from outside Western Hemisphere	30	770	125	150	125	600
Add forward obligating authority	-1	-67	-1		-200	-50
Subtract GARIOA	-321	-964	100	to	200	to
Subtract financing from International Bank, etc.			-1.15	-840	-829	-4,165
Net United States appropriation needed	1,328	5,42	4,035	2,777	1,1	15,111
			to 4,500	to 3,650	to 2,650	to 17,758

It is to be expected that favorable price and other factors will reduce the cost of the program below the higher figure in the range of estimates. However, it would be unwise to count on the full measure of price declines and other favorable factors reflected in the lower figure. The estimated 4 1/4-year requirement is, therefore, \$17,000,000,000. This lies between the high and low estimates and would cover somewhat more than two-thirds of the contingencies which are reflected in the range.

The CHAIRMAN. Mr. Webb, will you agree with me that due to the necessary imperfections in the estimates on our foreign-aid programs, due to the shortness of time in which to prepare them, that it becomes necessary that we lodge the largest discretion with an administrator of the ERP program. There is no alternative to that, is there?

Mr. WEBB. I think wide discretion will be required.

The **CHAIRMAN**. So that, if not the Congress, the director of tile program will have to exercise his judgment as to what can and what should be spent in the fiscal year 1949. Is that not correct?

Mr. WEBB. Under our system, Senator, as you know, the administrator, or whoever is responsible for those funds, must come forward to Congress with a plan as nearly complete as he can make it and justify the request for funds.

The **CHAIRMAN**. You are talking about the mechanics of the fund?

Mr. WEBB. Yes.

The **CHAIRMAN**. I am talking about the range of the director's discretion. His discretion may be upset by the Congress; it may be approved by the Congress. He may receive additional directions from the Congress.

Mr. WEBB. That is right.

The **CHAIRMAN**. But under the necessary structure of the ERP program, due to the fact that what might be called firm estimates are impossible and due to the necessity for haste, the director must have a wide range of discretion as to what to spend during the fiscal year and where to spend it.

Mr. WEBB. I think so.

Tile **CHAIRMAN**. Is that not correct?

Mr. WEBB. I think so.

The **CHAIRMAN**. So that there is a field where either in tile hands of the Congress or in the hands of the director there is a possible wide range for adjustment.

Senator **MARTIN**. Mr. Chairman, may I ask a question?

The **CHAIRMAN**. Yes, Senator Martin.

Senator **MARTIN**. Mr. Webb, as I understand it, there is now quite a large sum that might be considered for European relief that comes under the budget for the armed services. Is that correct?

Mr. WEBB. There is an item that is called government and relief in occupied territory which runs to around \$1,250,000,000 in the 1949 budget.

Senator **MARTIN**. Could you give us that set-up-the amounts used in the various countries?

What I am getting at, Mr. Chairman, I think the Congress and the people of the United States are entitled to know tile over-all total that will be used for relief and rehabilitation of distressed countries.

Mr. WEBB. Yes, sir. We can furnish you with that information. (The information requested is as follows:)

TABLE V.—Estimated foreign-aid expenditures, by country and purpose

(In million of dollars)

Program by countries	Fiscal 1948		Fiscal 1949		Total
	Relief		Disaster-struck	Military	
I. PRESENT					
1. Relief assistance to war-devastated countries	272	272	30		602
Italy	93	93	24		24
Austria	71	71	18		18
Greece	30	30			3
China	20	20	7		7
Not distribute	47	47			

TABLE V.—Estimated foreign-aid expenditures, by country and purpose—Con.
 (In millions of dollars)

Program by countries	Fiscal 1948:			Fiscal 1949		
	Recon- struc- tion	Milli-	Total	Relief	Recon- struc- tion	Total
I. PRESENT—con.n.						
2. Foreign interim aid	375		375	162		
France	1953		19	89		
Italy	12		1255	561		
Austria	39		16	18		18
China	1033		10	2		2
3. occupied areas			910	1,230		
Germany	628		828	9		679
Austria	10		10	13		13
Japan and Ryukyus	353		353	429		429
Korea	107		707	125		125
Administration	(1)					4
4. Export-Import Bank		736				
Loans presently authorized:						
Latin America	132				97	97
Canada	150				1500	1500
Austria	14					
Belgium	25					
Denmark	6					
Ecuador	35					
France	202				2	
Greece	8					
Italy	105					
Netherlands	8					
Norway						
Poland	32					
Turkey	82					
China	22				165	16
Japan	1				14	14
Saudi Arabia	18					
Other countries	0					
Undistributed	26				2	2
New loan authorization	67				325M	325
Repayments and other ad- justments	-202				-155	-15
5. British loan: United Kingdom...	1		1,70		00	
6. Aid to Greece and Turkey	83	1900	275		37	82
Greece .....	.85	120	205		37	52
Turkey .....		.70	7			30
7. Philippine rehabilitation: Philip- pine Islands						
8. Philippine war damage: Philip- pine Islands			51		123	123
9. International Refugee Organiza- tion (not distributed by coun- tries)	71		71	71		71
10. UNRRA	201		201	1		
Albania	8					
Austria	4					
Byelorussia	1000					
China	10		100			
Czechoslovakia						
Ethiopia						
Finland	12					
Greece	7		1			
Hungary	16					
Italy						
Korea						
Philippine Islands						
Poland	18					
Ukrainian SSR	4					
Yugoslavia	25					
Subtotal, existing pro- grams	1,917	2,615	190	4,722	847	718
					82	2,347

See footnotes at end of table.

TABLE V.—Estimated foreign-aid expenditures, by country and purpose—Con.

Program by countries	Fiscal 1948				Fiscal 1949		Total
	Relief	Recon- struction	Mil- itary	Total	Recon- struction	Total	
II. PROPOSED							
1. European recovery program ¹	65	500		565	4,000		4,565
2. Aid to China					13		13
3. Aid to Greece and Turkey (divi- sion between countries not yet decided)					1500		1500
4. Aid to Trieste	2			2	1		3
5. Latin-American military coopera- tion (division between countries not yet decided)			2	2			4
6. Far-eastern reconstruction (divi- sion between Japan, Korea, and Ryukyus not yet decided)		25		25	175		200
Subtotal, proposed pro- grams	67	525	2	594	4,190	158.8	4,751.8
Existing programs	1,917	2,615	192	4,724	1,547	82	6,273
Grand total	1,984	3,140	192	5,316	5,737	240	11,053

¹ Less than \$300,000.

² Country totals shown below are in terms of estimated shipments for period Apr. 1, 1948, through June 30, 1949, expressed in prices of July 1947. To get to estimated expenditure, total for entire program, the over-
all adjustments shown below were made for price increases entering the line of shipment of tea and
financed from pre-ERP sources, and time lag between shipments and payments. These adjustments have
not been broken down by countries, so that expenditure estimates for each country are not available at this
time:

Austria	182	Germany (exclusive of GARIOA)	383
Belgium-Luxemburg	323		
Denmark	104	Total shipments at July 1947 prices	6,238
France	1,434	Plus: Price increase since July 1947	482
Greece	11		
Iceland	13		
Ireland	162	Time lag between shipment and payment	1.50
Italy	86	Interim pipe line of shipments from pre-ERP sources	20
Netherlands	77		
Norway	34		
Portugal	33		
Sweden	33		
Switzerland	33		
United Kingdom	1,700	Net expenditures	4,000

The CHAIRMAN. Mr. Webb, on housing, when you appeared before the House Ways and Means Committee, did you not testify in substance that the figure which is in the President's budget was necessarily a rounded, rough-estimate figure because at that time the detailed statements had not been prepared?

Mr. WEBB. Which figure was that? On the housing figure?

The CHAIRMAN. Yes.

Mr. WEBB. I believe that is so. My recollection is that I used an estimate of about \$150,000,000. Is that the figure? Or am I thinking about a different program?

Mr. Reeve tells me that the testimony at that time was that the figure of—yes; I used the figure of \$150,000,000 in 1952. That is correct.

The CHAIRMAN. Did you not testify, in effect, that you could not put a sound estimate on the whole program that was in mind because the estimates had not been prepared?

Mr. WEBB. That is correct. That is a projected program.

The CHAIRMAN. And because it is projected, or at least despite the fact that it is projected, you did not have the basic trench-digging estimate work in hand to give a reasonably accurate figure so far as the field of housing is concerned, under the President's program?

Mr. WEBB. That is correct. And in the meantime the President has submitted an additional message which was the item I referred to this morning.

The CHAIRMAN. I wish he would stop that habit.

Now, as I understand it, the President's budget has proposed expenditures in it of approximately 5.7 billion dollars, which will require authorizations as well as appropriations; in other words, they are beyond existing functions of Government. Is that correct?

Mr. WEBB. Yes, sir. That is right.

The CHAIRMAN. So that there also is a field where the Congress will have considerable leeway so far as its judgment of the policies and necessities involved are concerned.

Mr. WEBB. They have complete discretion, Senator, to adopt it or not.

The CHAIRMAN. Something you said a while ago, I do not believe that this would be your final conclusion, I gathered that you were rather inclined to believe that if we adhere to the desirability or necessity of a program we must, at the same time, close our eyes to possible waste in that program.

I reached that conclusion because you disassociated, in the course of your statement, these grand international and military objectives and then finally you reduced the possibility of savings in pay roll to a billion dollars, and under your theory that will result in a very drastic reduction in pay roll with possible impairment of function.

Cannot the pursuit and elimination of waste, go hand in hand with the declaration and achievement of fine objectives?

Mr. WEBB. I think it should.

The CHAIRMAN. In other words, it should apply to our foreign-aid program, it should apply to our military program, it should apply to every program that you have mentioned that involves such large sums of money.

Mr. WEBB. I think the great problem of making government really work is to find a way to do the things that in our democracy the Congress approves, efficiently and economically, so that we have the support of people rather than criticism on small matters.

The CHAIRMAN. So that in our search for waste we are not precluded from looking at those with the grand objective, as well as the old routine functions of government. Is that not correct?

Mr. WEBB. I think you should examine them very carefully.

The CHAIRMAN. I assume that you believe that this budget is irreducible, but that you have also conceded that the Congress might not consider it so and might consider that there is considerable waste all the way along the line in all of the major fields of governmental activity.

Now, what are the funds which are unobligated, carried over into fiscal 1949, which do not reflect in the President's estimate of expenditures?

Senator LUCAS. Will you repeat that last question, Mr. Chairman?

The CHAIRMAN. I believe there are some unobligated funds which might, under authorizations and appropriations previously made, be expended in fiscal 1949 but which do not reflect in the President's expenditure budget. I am trying to get the magnitude of that.

WEBB. Senator, on page 212 of the House Ways and Means Committee hearings, I inserted a table giving tile balances available by agencies, including tile legislative, judicial, and executive branches, showing the obligated, unobligated funds, and the balances on July 1, 1948, which would expire and not be available in 1949.

The CHAIRMAN. What I am asking you is, what part of those obligations have been omitted from the President's expenditure budget for 1949?

Mr. WEBB. The July 1 balances that have been omitted are those which would expire at the beginning of the fiscal year, and could not be spent in that year.

The CHAIRMAN. Are there any which would not expire under the terms of which the President, in his discretion, could make expenditures in fiscal 1949 which expenditures are not reflected in his budget for fiscal 1949?

Mr. WEBB. We have filed with the Appropriations Committees rather complete sets of tables—I believe they run to almost a hundred pages—which show the details of all those funds. The Budget itself carries expenditure estimates to be made from all funds, including any which may be carried forward into this year.

You understand that each one of these, that is, whether or not it can be obligated, is determined by the specific law which sets up the fund.

The CHAIRMAN. I understand that completely. So what I am putting to you is, which of those unobligated funds which have not ended by terms of law by fiscal 1949, if any, have been carried over into the President's expenditure budget for fiscal 1949 and which have not been?

Mr. WEBB. Would you like me to supply you a table for the record?

The CHAIRMAN. Yes.

Senator TAFT. Why would you omit any expenditures that you think are going to occur, from the President's expenditure budget?

Mr. WEBB. There are no expenditures omitted. The Senator is referring to funds that will be unobligated at the end of the fiscal year, and which may be obligated in the following year. He is not referring to expenditures.

Senator TAFT. He asked you whether you omitted any of the expenditures under those funds in your expenditure budget, and I say why should you.

Mr. WEBB. I do not. I said before you came in that no expenditures were omitted from the budget.

Senator TAFT. No probable expenditures. I suppose some of these funds might be spent more freely than you think they are going to be, might they not?

Mr. WEBB. The budget is the most realistic and complete estimate we could make at the time it was submitted.

REDUCTION OF INDIVIDUAL INCOME TAXES

The CHAIRMAN. May we then take it as a firm assurance that there are no unobligated funds that would not extinguish in fiscal 1948, that this will be expended in fiscal 1949?

Mr. WEBB. Let me look at this table for a moment.

The CHAIRMAN. All right.

May I make myself a little bit clear. If you have not put in the President's budget unobligated funds carrying over from the previous fiscal year, which you intend to spend in fiscal 1949, it is perfectly apparent that your expenditure budget for fiscal 1949 is grossly distorted. Now, I am just trying to find out which of two things is true: Either that there are no obligations of that kind going over, or that if there are unobligated funds of that kind going over that they will or will not be spent in fiscal 1949.

Mr. WEBB. Senator, the budget does not normally carry every detail of the obligability of funds. It carries the appropriations and it carries the expenditures to be made under those.

Now, here are a great many details of just when funds expire. We have applied a complete statement of that to the Appropriations Committee, and I have it here.

The CHAIRMAN. Mr. Webb, I think you are on rather shaky ground.

Senator TART. Why do you not answer the question, Mr. Webb?

The CHAIRMAN. Does not your expenditure budget contemplate the expenditures that you are going to make in the fiscal year?

Mr. WEBB. Yes, sir.

The CHAIRMAN. Then would it not include unobligated funds that passed over from the preceding fiscal year?

Mr. WEBB. It would include any -

The CHAIRMAN. Then we should expect to find those in the estimate of expenditures, should we not?

Mr. WEBB. Right. And they are there.

The CHAIRMAN. And if we assume that they are not in there, then we have had what is the equivalent of an Executive rescission of the amount.

Mr. WEBB. Let me ask Mr. Lawton to answer that question. He has prepared that table and has been in this work for many years.

Mr. LAWTON. Some of the presently available funds will carry over for expenditure beyond 1949.

The CHAIRMAN. I am not talking about beyond 1949. I am talking about 1949. I will come to beyond 1949 later.

What is the carry-over of unobligated funds into fiscal 1949 which will be spent in fiscal 1949, and which do not reflect in the President's budget of expenditures?

Mr. LAWTON. I do not know of any that do not reflect in the President's budget.

The CHAIRMAN. First, will you give us a table which will make that very clear?

(The information requested follows:)

TABLE VI.—*Relationship of estimated expenditure authority to estimated expenditures, fiscal year 1949 (based on the recommendations in the 1949 Budget)*

[In millions of dollars]

Source of expenditure availability	Estimated amounts available for 1949	Disposition of expenditure availability -		
		Estimated expenditures in 1949	Estimated balances available after June 30, 1949	Estimated amounts not available after June 30, 1949
General and special accounts, other than statutory public debt retirements:				
Appropriations for the year:				
Specific appropriations recommended to Congress	21,581	20,964	3,697	11
Indefinite appropriations recommended to Congress, estimate	340	330	10	
Supplemental appropriations to be recommended to Congress, tentative forecast	2,117	1,653	465	
Permanent appropriations under existing law, estimate	5,745	5,416	37	272
Subtotal, appropriations for the year	32,783	28,363	4,138	283
Other authorizations available:				
Reappropriations of balances, not otherwise available, recommended to Congress	1	1		
Appropriations for 1949, to be immediately available and used in 1949	50	50		
Balance of authorizations to use public debt receipts for expenditure, estimate	2,540		2,540	
Balance of appropriations already enacted, available for expenditure, estimate:				
Obligated	7,211	5,378	1,828	5
Unobligated	2,076	615	1,311	120
Balance of anticipated supplemental appropriations for 1948, available for expenditure, estimate:				
Obligated	847	819	28	
Unobligated	6,000	3,700	2,300	
Total, general and special accounts	51,568	38,955	12,115	497
Checking accounts with U. S. Treasurer, other than cancellation of Government corporation notes:				
Cash balance in checking accounts with Treasurer, estimate	609	35	574	
Balance of unused borrowing authority, estimate	9,021	809	8,014	1,038
Increase in borrowing authority, estimate	835			
Repayment of borrowing, not affecting borrowing authority, estimate		130		130
Total, checking accounts with U. S. Treasurer	10,465	714	8,588	1,163
Grand total	61,972	39,669	20,373	1,571

¹ This amount consists of a \$2,540,000,000 balance of an authorization treated as a public debt transaction, \$8,690,995,420 of obligated balances in appropriation and fund accounts, and \$905,157,298 of unobligated balances in appropriation and fund accounts.

² Deduct.

NOTE.—The foregoing table excludes the appropriations, balances, and expenditures for statutory public debt retirement:

Permanent appropriations for fiscal year 1949	\$621,763,000
Appropriation and fund balances brought forward, available for expenditure in 1949	5,957,080,681
Total available in 1949	6,581,843,681
Expenditure for statutory debt retirement in 1949	624,763,000
Balance available after June 30, 1949	5,957,080,681

The foregoing table also excludes unobligated balances as of July 1, 1948, in expired accounts, estimated at \$625,330,507. Balances in expired accounts are available for expenditure only in payment of obligations which were incurred in the prior year or years for which the appropriations were made; therefore, no expenditures are estimated from these unobligated balances. The unexpended balances in such accounts will automatically be carried to surplus on June 30, 1949, and June 30, 1950.

The CHAIRMAN. Second, if there were any such, which do not reflect in the President's budget, expenditure budget for fiscal 1949, may we assume that that money will not be spent in fiscal 1949?

Mr. LAWTON. That is right.

The CHAIRMAN. As a matter of executive policy? Is that right?

Mr. LAWTON. That is right.

The CHAIRMAN. You will furnish the data?

Mr. LAWTON. Yes, sir.

Senator BARKLEY. What is the technical definition of unobligated sum? We appropriate money. Sometimes it expires at the end of a fiscal year. It is no longer available, it cannot be obligated after that date, it goes back into the Treasury into the general fund.

Other appropriations go over beyond the fiscal year in which they are made. They may go for a year or 2 or 3 years. The string out over a period of years. Which category of obligations or unobligation do those two situations come into?

Mr. LAWTON. An appropriation that is made for a fiscal year must be obligated within that fiscal year if it is to be spent at any time.

Senator BARKLEY. And that obligation takes place by the executive department?

Mr. LAWTON. Yes, sir.

Senator BARKLEY. In fact, it might entirely lapse if the executive department did not obligate it or spend it, or obligate it for expenditure in that period.

Mr. LAWTON. That is right.

Senator BARKLEY. It may not be expended in that year, but it must be obligated?

Mr. LAWTON. The averages of appropriations are approximately seven-eighths of the appropriations expended within the year, but they must all be obligated.

A great many appropriations for public works and some for other general purposes, specific legislative purposes, are made on the basis that they are available until expended. Those appropriations do not have to be obligated within the fiscal year. They do not expire for obligation, but remain available for both obligation and expenditure until the appropriation is exhausted.

Senator LUCAS. That last type, that is in line with what the Congress has said you should do.

Mr. LAWTON. That is right. The appropriation act specifically states that it is available until expended.

Senator BREWSTER. There is one specific illustration that may perhaps bring this out. The appropriations for construction of airports, in which there was an authorization of, I think, around 50 or 60 million dollars, which the President last fiscal year revoked and said that none of it should be spent during that year, was all carried over.

Now, you estimated in this year, in this year's budget, I assume, the expenditure of much of that fund, did you?

Mr. LAWTON. We estimated the expenditure of funds for the construction of airports for the Federal airport aid program. We estimated expenditures from obligated balances of \$45,000,000.

Senator BREWSTER. Do you have the figures as to how far that estimate has been realized? My information is that it was very little.

REDUCTION OF INDIVIDUAL INCOME TAXES

Out of \$75,000,000 that has been authorized so far, only \$13,000,000 has been obligated to date, so that it seems likely that very little of that money will be used this current fiscal year.

Do you have the figures on that?

Mr. LAWTON. I do not have the figures here with respect to 1948 appropriations. This is a 1941 expenditure that I am referring to.

Senator BREWSTER. You have estimated for the next fiscal year

Mr. WARD. Of expenditures, Senator.

Senator BREWSTER. Yes; I understand.

Senator TART. Page A52 of the Budget.

Mr. LAWTON. We have estimated \$21,500,000 will be spent in 1948.

Senator BREWSTER. When was that estimated?

Mr. LAWTON. That is included in the budget.

Senator BREWSTER. The latest testimony we have is that only \$13,000,000 will be obligated up to this past month, which would make it very difficult to spend 21,000,000, would it not?

Mr. LAWTON. It may be. I have not examined that program recently. But there do remain 4 months for obligation and expenditure within the year.

Senator BREWSTER. I understand.

Senator BARKLEY. What happens in this case; We appropriated a lot of money for flood control for the fiscal year 1948. The President, by Executive order eliminated a lot of it and then restored some of it. But it has not all been restored. What happens to that specific appropriation for any particular flood-control project that the President by Executive order eliminates. Does that expire at the end of the year, or does it go over into the next year?

Mr. LAWTON. It continues available until expended. The President did not eliminate the expenditures; he delayed them.

Senator BARKLEY. And it may be obligated during the following fiscal year?

Mr. LAWTON. It may be obligated and spent during the following, or several following, fiscal years.

Senator BARKLEY. In view of his order postponing or delaying, it could not be obligated in the fiscal year for which appropriated?

Mr. LAWTON. That was the purpose of it; yes.

Senator BYRD. Mr. Lawton, the budget is entirely on the expenditure basis, of course.

Mr. LAWTON. The budget includes, in submission both appropriations and expenditures. The figures that are normally referred to, the 30.7, is an expenditure figure.

Senator BYRD. It has nothing to do directly with authorizations or obligations or anything else. That is the amount of money that you estimate will be spent, actually spent, out of the Treasury within the next fiscal year.

Mr. LAWTON. That is right.

Senator BYRD. That is an expenditure basis entirely.

Senator TART. In making an expenditure, do you therefore include (1) what you estimate will be spent out of a new appropriation; (2) what you estimate will be spent from funds that have been obligated before the 1st of July but not paid out; (3) the things that you estimate

will be spent from appropriations which carry over, even though they have not been obligated? Is that right

Mr. WEBB. Yes, sir.

Senator **TAFT.** Expenditures items are made up of those three separate items. Are there any others?

Mr. LAWTON. There are expenditures, of course, from the checking account of corporations that enter into the budget on the basis of corporate authorizations for expenditure, and there are expenditures from authorizations for programs which are treated as public-debt transactions, such as the British loan and things of that sort.

Mr. WEBB. And some, what we call no-year appropriations, that carry forward, such as the public debt.

Senator **TAFT.** That was included in my third category.

The **CHAIRMAN.** Has there been the slightest doubt in your mind as to what I want?

Mr. LAWTON. No, Senator. What you want is the amount of unobligated funds that came into 1949 and that will be spent in 1949, and whether or not there are any of such funds that are omitted from the budget that are actually expected to be spent.

The **CHAIRMAN.** Right.

Senator **TAFT.** In estimating those expenditures, do you ask the departments, or do you estimate on a percentage basis what percent of the appropriations are usually spent? How do you get those estimates for expenditures?

Mr. WEBB. They differ with the differing programs. We do utilize all the information that departments have. But we have, in our Estimates Division, men who have had broad experience with things like these big public-works programs, and we make our own estimates of the expenditures.

Looking at the broad program, you usually can do a much better job than if you tend to add up the individual items that go in it. So we utilize both types of information.

Senator **TAFT.** You take a kind of a Gallup poll?

Mr. WEBB. No, sir; not exactly. We have developed some criteria, Senator, that have been very helpful over a long period of time in judging the amounts that will be spent.

I might say that that is a difficult problem to handle with the heads of the executive departments when we try to make our expenditure estimates completely realistic, and they feel that they can maybe move a little bit faster.

The **CHAIRMAN.** Mr. Webb, if the President's supplemental request with respect to the 1947 budget had been met by Congress, how much would the estimate, the Presidential estimate of expenditures in the fiscal year 1947, have been exceeded?

Mr. WEBB. Let me see if I have any figures here on that. You mean for the fiscal year 1947?

The **CHAIRMAN.** Fiscal 1947.

Mr. WEBB. No, sir. I do not have anything as far back as 1947.

The **CHAIRMAN.** Will you take the list of the President's supplemental requests that were not embodied in the budget, as presented for fiscal 1947, and put them in the record, please?

Mr. WEBB. Yes, sir.

(The information requested follows:)

To furnish to the committee the information requested, as to the amount by which the President's original estimates for 1947 would have been exceeded had all supplemental estimates requested by him been enacted, will require a detailed analysis of each supplemental request for that year. This analysis has started, and the committee will be furnished with the information at the earliest possible date.

The analysis referred to is necessary because the budget for the fiscal year 1947, submitted in January 1946, contained (1) estimates of expenditure based on the specific recommendations for appropriations set forth in that budget and carry-over balances; (2) a lump-sum estimate of expenditures from anticipated supplementals to be submitted at later dates; and (3) estimates of expenditure based on proposed legislation for which supplemental appropriation estimates would be submitted following enactment of the legislation.

The supplemental estimates actually submitted must be analysed to determine those that fall into one of the foregoing three categories, those that involved restorations of cuts made by Congress in items included in the budget, and those that were for purposes not contemplated when the budget was originally submitted. This latter class will represent the President's proposals for additional expenditure above the amount originally contemplated.

The CHAIRMAN. What is the situation in that respect as to fiscal 1948?

Mr. WEBB. I supplied a table to the House Ways and Means Committee with respect to the 1948 budget.

The CHAIRMAN. May we back up so that I can ask you what was the expenditure estimate for fiscal 1948?

Mr. WEBB. Originally submitted, sir?

The CHAIRMAN. Originally submitted.

Mr. WEBB. \$37,528,000,000.

The CHAIRMAN. Then how much would that have been exceeded had the President's supplementals presented during that fiscal year for expenditure in that fiscal year been granted?

Mr. WEBB. I will have to furnish that. I do not have a list of all of the supplementals that were submitted here.

Senator BARKLEY. You assume that none of the supplementals were carried in appropriation?

The CHAIRMAN. No; I am asking for the information as to the requests made and as to if the requests had been granted how much the expenditure budget of fiscal 1948 would have been exceeded.

(The information requested is as follows:)

	Millions
Estimated expenditures in 1948 budget	\$37,528
Estimated expenditures against supplementals (total)	1,945
1. Amendments to the budget through December 1947 (net) ..	\$1,044
2. Anticipated supplementals to be considered by 2d sess.,	
80th Cong	901
Deduct expenditures against supplementals submitted to restore cuts by	
Congress in the estimate of \$37,528,000,000 in line 1 above.....	- 857
Estimated additional expenditures (net)	1,088
Total expenditures if all estimates were enacted.....	38,616

Senator BARKLEY. I think you ought to include in that table the amount of supplementals that Congress approved and appropriated money for.

The CHAIRMAN. I have no objection to having that included.

Mr. WEBB. I can give you the total of the supplemental. This is 1948. I can give you the total of the supplementals submitted by the President, and the total is \$3,116,120,000, rounded off.

The CHAIRMAN. During the fiscal year 1948?

Mr. WEBB. Yes, sir.

The CHAIRMAN. And those represent requests made after the original budget was submitted?

Mr. WEBB. Yes, sir. Some of those were included in the original request as anticipated supplementals.

The CHAIRMAN. Can we have a figure on that, as to those that came then and those that came after the original submission?

Mr. WEBB. Yes, sir.

(The information referred to is as follows:)

TABLE VII.—Summary of supplemental appropriations for the fiscal year 1948, recommended to the first session of the Eightieth Congress and the amounts included as anticipated supplemental appropriations in the 1948 Budget, submitted in January 1947

Agency	Recommended to 80th Cong., 1st sess.	Anticipated in the 1948 budget (table 10)	Excess of recommended over anticipated
Legislative branch.....	\$7,889,703		\$7,889,703
The Judiciary.....	1,835,420		1,835,420
Executive Office of the President.....	1-20,049,000	\$62,250,000	-82,279,000
Funds appropriated to the President:			
European interim aid.....	597,000,000		597,000,000
Assistance to Greece and Turkey.....	400,000,000		400,000,000
Relief assistance to war-devastated countries.....	350,000,000		350,000,000
Surplus property, care and handling overseas.....	78,000,000	20,000,000	58,000,000
Defense and liquidation.....	700,000		700,000
Independent offices.....	157,902,500		157,902,500
Federal Security Agency.....	31,458,739	80,859,000	-49,430,261
Federal Works Agency.....	8,764,000	25,000,000	-16,236,000
Department of Agriculture.....	59,558,000	3,500,000	66,058,000
Department of Commerce.....	104,191,600	65,007,500	39,183,600
Department of the Interior.....	45,019,500		45,019,500
Department of Justice.....	8,740,000		8,740,000
Department of Labor.....	5,400,000	2,600,000	2,800,000
Post Office Department.....	162,384,100		162,384,100
Department of State.....	83,349,881	56,452,000	-3,102,119
Treasury Department.....	187,279,000	31,683,000	155,596,000
National Military Establishment:			
Office of Secretary of Defense.....			
Department of the Air Force.....			
Department of the Army.....	788,705,000	279,000,000	509,705,000
Department of the Navy.....	8,850,000	37,000,000	-28,150,000
District of Columbia.....	710,000		710,000
Government corporations and credit agencies.....	44,400,000	5,000,000	39,400,000
Reserve for contingencies.....		25,000,000	-25,000,000
Total.....	3,116,120,453	723,361,500	2,392,758,953

¹ This minus figure is due to a requested reduction of \$20,750,000 for War Assets Administration and \$33,000 for the Council of Economic Advisers in the estimates recommended in the 1948 budget.

The CHAIRMAN. What Presidential requests have there been since the budget for fiscal 1949 was submitted that are not included in the original budget for fiscal 1949?

Mr. WEBB. Would you like Mr. Martin, the head of our Estimates Division, to answer that, Senator?

The CHAIRMAN. Yes.

Mr. WEBB. I would like to give you the best information we have.

Mr. MARTIN. Senator, in the preparation of the 1949 budget there were some items which came in too late for inclusion in the detail of

the budget. We included, however, a contingency item in the budget of some \$125,000,000. The largest amounts involved concerned the Post Office Department, where information as to the increase in mail transportation rates did not become available until December 21. There was a considerable proportion of the contingency item chargeable to the Post Office budget.

The CHAIRMAN. Does the original budget for fiscal 1949 reflect the additional requests that are coming in for Greece and Turkey?

Mr. MARTIN. The budget had \$440,000,000 of estimated expenditures, I believe, for other foreign aid.

The CHAIRMAN. That would be Korea, China, Greece, Japan, and Turkey?

Mr. MARTIN. Yes, sir. And the present estimate I think is \$600,000,000, in view of the current developments.

The CHAIRMAN. Are there any commitments, so far as you know, for assistance to South American countries, or to any countries to the south of us, that have not come in yet?

Mr. LAWTON. Yes, sir. There is an item covering a bill now pending before the Congress for military aid to South America, which has not been submitted.

The CHAIRMAN. Is that an administration measure?

Mr. LAWTON. Yes, sir.

The CHAIRMAN. It was not in the expenditure budget for fiscal 1949?

Mr. LAWTON. It was in. The appropriations estimate has not come up yet.

The CHAIRMAN. I am driving at the amounts that were not in which are now covered by supplemental requests.

Mr. MARTIN. There are very few, Mr. Chairman. The increase in other foreign aid is an example of an understatement in the budget. Most of the supplementals that were sent up in House Document 504, which is about \$3,000,000,000, represented items which were either specifically set forth as supplementals to going programs or as anticipated supplementals by one-line items in the budget.

The CHAIRMAN. You will give us for the record the exact overage so far developed by the request for supplements for foreign aid or for foreign military expenditures in connection with the budget for fiscal 1949.

Mr. MARTIN. Yes, sir; that is over and above the amount directly set forth in the budget or included in our contingency item.

(The information requested is as follows:)

Estimated expenditures for international aid other than the European recovery program have increased \$160,000,000 since the 1949 budget was submitted.

Senator **LUCAS.** Mr. Chairman, before you leave that inquiry—

The CHAIRMAN. Surely.

Senator **LUCAS.** May I inquire of Mr. Webb or someone of his staff as to how much Congress appropriated for items for fiscal 1948 that were not included in the President's budget?

Mr. WEBB. We could supply that to you, Senator.

The CHAIRMAN. I think that is a very relevant figure and might be put in.

See table IX., p. 82.)

Senator **LUCAS.** I would like to have that for 1948 and also for 1949.

NOTE.—No figures for 1949 are available since Congress has not completed action on any 1949 Appropriation Act.

REDUCTION OF INDIVIDUAL INCOME TAXES

I would like to ask at this point whether or not you have compiled figures to show whether we saved any money in fiscal 1948 on the recommendation of expenditures made by the President of \$37,528,000,000?

Mr. WEBB, Senator, we supplied to the House Ways and Means Committee a statement of all changes in the 1948 budget which took place between the original submission in January 1947 and the revised figures in January 1, 1948, and indicated by short notes what had brought about those changes. I would be glad to supply that same statement for your record if you wish.

Senator LUCAS. I wish you would. And if you can give me the answer at this time I would appreciate it.

(The information requested is as follows:)

TABLE VIII.—The 1948 budget—Comparison of estimates of Federal budget expenditures for the fiscal year 1948, as shown in 1948 budget documents

In millions of dollars)

Function and programs	1948 ¹ budget document	1949 ⁰ budget document	Change	Explanation
National defense:				
Air and Army defense	6,526	6,204		Largely congressional action and inability to recruit.
Naval defense.....				Reflects congressional action and lag in programs.
Proposed legislation				Delay in passage of authorizing legislation for military and naval public works.
Terminal leave, stock-piling, and other.				Unanticipated supplemental for stock-piling and carry-over of war liquidation expenses from 1947.
Total, national defense	11,556	10,746	-- 810	
International affairs and finance:				
Reconstruction and stabilization:				
Present programs:				
Greek, Turkish aid (act of 1947).....		275		New program proposed after January 1947.
Other		2,459		Mainly increase in withdrawals under loan to United Kingdom because of higher prices and dollar shortage.
Proposed legislation:				
European recovery program.		300		New program proposed after January 1947.
Other aid legislation				Other foreign aid programs, including aid to China.
Foreign relief:				
Interim aid (act of 1947).....		375		New program propose after January 1947.
Post-UNRRA.....	250	272		Scheduled 1947 expenditures displayed 1948. ²
Army (occupied countries).....	615	998		Crop failures abroad, increased prices and assumption of British dollar costs for bizonal area of Germany.
Other.....	381	272	-109	Mainly decline in estimate for UNRRA expenditures.
Other international activities, including Philippine rehabilitation:				
Present programs.....	343	17	-50	Mainly lower rate of expenditures for Philippine rehabilitation program.
Proposed legislation.....		3	+35	Mainly for Swiss war damage claims and loan for United Nations headquarters construction.
Total, international affairs and finance.	3,510	5,533	+2,023	

¹ See footnotes at end of table.

TABLE VIII.—The 1948 budget—Comparison of estimates of Federal budget expenditures for the fiscal year 1948, as shown in 1948 budget documents—Con.

[In millions of dollars]				
Function and programs	1948 budget document	1948 budget document	Change	Explanation
Veterans' services and benefits:				
Pensions	2,492 ²	2,055	-437	Reduction in estimate of number on rolls and in average payment.
Insurance	73	164 ¹	+91	Part of transfers to trust fund delayed from 1947 to 1948.
Readjustment benefits	3,462	3,331	-111	Sharp decline in unemployment benefits; increase in education and training.
Hospitals, other services, and administrative costs.	1,315⁵	1,071	-244	Inability to award hospital construction contracts because of high construction costs.
Total, veterans' services and benefits.	7,343		-711	
Social welfare, health and security:				
Retirement and dependency insurance.	490	767 ⁷	+277	Appropriation to complete transfer of 1917 railroad tax collections to railroad trust funds not enacted until 1948.
Proposed legislation, 1948 budget..	7 ⁴			
Other	1,090	1,103	+13	Increase in Federal matching requirements for grants to States for public assistance.
Total, social welfare, health, and security.	1,567 ⁴	1,870	+303	
Housing and community facilities:				
Aids to private housing	250	-89	-339	Mainly reduction of RFC purchase of home mortgages guaranteed by Veterans Administration (new RFC charter, as of June 30, 1947, discontinued authority to make further commitments).
Proposed legislation, 1948 budget...	14		-14	Enactment of pending housing legislation delayed.
Other	275 ⁵	352	+77	Net changes in numerous program estimates.
Total housing and community facilities.	539	113	-426	
Education and general research	88	77	-11	Reduction in appropriations principally for Library of Congress; delay in construction (Howard University).
Agriculture and agricultural resources:				
Price support, supply, and purchase programs (Commodity Credit Corporation)		247	+247	Reduced outlays for agricultural price support because of lower prices; also increased receipts resulting from sale of Cuban sugar purchased in June 1947.
Other	1,051 ¹¹	861	-190	Mainly decreased appropriations for Farmers Home Administration and for the conservation and land-use program.
Total, agriculture and agricultural resources.	1,381	614 ⁴	-767	
Natural resources not primarily agricultural.			+78	Mainly increase in flood control (Corps of Engineers, civil).
Transportation and communication:				
Promotion of the merchant marine.	204 ¹	12 ²	+192	Elimination of Maritime Commission revolving fund and extension of authority to operate ships.
Other	1,326		-91	Mainly reductions in appropriations for navigation aids and facilities (Coast Guard) and for provision of aviation facilities.
Total, transportation and communication.	1,530	10	+1,520	

See footnotes at end of table.

REDUCTION OF INDIVIDUAL INCOME TAXES

TABLE VIII.—The 1948 budget—Comparison of estimates of Federal budget expenditures for the fiscal year 1948, as shown in 1948 budget documents—Con.

[In millions of dollars]

Function and programs	1948 budget document	1949 budget document	Change	Explanation
Retirement of smaller War Plants Corporation capital stock.	100	15		Retirement estimated for 1948 was made in 1947.
Other present programs	310	333		Net effect of increases and decreases in various programs.
Proposed legislation	10	24		Proposed legislation in 1948 budget for census of business, in 1949 budget mainly for anti-inflation program.
Total, finance, commerce, and industry.	420	372	-48	
Labor	1183	97	-21	Reductions in appropriations, principally for employment service.
General government	1,492	1,473	-19	Reductions in appropriations and other adjustments.
Interest on the public debt	8,000	8,200	+20	Mainly due to higher short-term interest rates and payment of accrued interest on terminal leave bonds cashed by veterans.
Refunds of receipts	2,005	2,049	-44	More recent estimate permits greater accuracy in rail rate collection.
Reserve for contingencies	25	120	+95	Post Office and all rail rate affecting uncertainties regarding foot-and-mouth disease control in Mexico.
Total, budget expenditures	37,828	37,728	+100	

Note.—Figures do not necessarily add to totals because of rounding.

Shown as anticipated supplemental in 1948 budget document.

Shown under proposed legislation in 1948 budget document.

Includes \$75,000,000 shown under proposed legislation in 1948 budget document.

Mr. WEBB. Between January 1947 and January 1948 the military expenditures were reduced downward from \$11,256,000,000 to \$10,746,000,000, or a reduction of \$510,000,000.

The first item of the Army and air defense was due largely to congressional action and inability to recruit. I would say of that \$322,000,000 probably half of it was due to congressional action and half of it to inability to recruit up to authorized strength.

I could go down through the two pages of this statement and give you that kind of information if you wish.

Senator TAFT. That is printed in the House records?

Mr. WEBB. No, sir.

The CHAIRMAN. Is is about two pages of records?

Mr. WEBB. Yes, sir.

(See table VIII, p. 79.)

The CHAIRMAN. Would you object to having it put in the record?

Mr. LUCAS. I want it in the record if I may have it, Mr. Chairman, but I would like to have the final answer on the difference between the President's estimate and what your records finally show that we spent.

(The information requested is as follows:)

TABLE IX.—Changes in the 1948 budget—January–December 1947

(Millions) (pns) J

Type of change	Authorizations		
	Appropriations ¹	New contract authorizations ²	Expenditures
January budget.....	\$31,292	\$1,642	\$37,528,628
A. Revisions due to changes in recommendations:			
1. Amendments to the Budget through December (net)	1,671 ¹	498 ²	1,044
2. Anticipated supplemental recommendations to be considered by second session of Congress.....	7,627	1709	9011
Subtotal.....	9,298	677	1,916
B. Revisions due to changes between fiscal years in program outlook:			
1. 7 appropriations delayed to 1948.....	360		63
2. Transfers of expenditures between fiscal years.....			245
3. Changes in estimates of outlook for Government program and revisions of related permanent and indefinite appropriations.....	301		-618
Subtotal.....	661		-210
C. Revisions due to congressional action:			
1. Reductions in authorizations which may be regarded as final.....	-1,691	-3	-1,272
2. (a) Reductions in authorizations which will require offsets by deficiency appropriations.....	-1,074		-913
(b) Estimated offsets by efficiency appropriations (or anticipated contract authorizations).....	95 ¹	75 ²	857
3. Reductions in Government corporation expenditures.....			-345
4. Revisions of authorizations of earlier years.....			1533
5. Substitution of contract authorizations for appropriations.....		181	
6. Increases initiated by Congress.....	373 ¹	1483 ²	2911
Subtotal.....	-1,439	401 ¹	-1,635
Total, 1947 Budget.....	29,813 ¹	621 ²	37,728.28

¹Includes reappropriations and appropriations to liquidate contract authorizations. Totals may not add because of rounding.

Mr. WENN. Do you wish me to pick it out now?

Senator LUCAS. Have you not the total figures now? The President said he wanted \$37,528,000,000. The Congress cut that down. But I am wondering whether or not, after all if we did not spend just about as much as the President requested. Have you that figure?

Mr. WEBB. The estimate shows an increase of about \$200,000,000. But there are many variations within the total and that was what I meant to indicate here.

For instance, the foreign-aid program shows an increase of \$2,000,000,000 in that year. Now, as to just which of those were initiated by the President, and the particular modifications made by Congress, would take some effort.

I could supply a statement without too much delay.

Senator BYRD. That is the total recommendation of the President for the fiscal 1948 for expenditure in fiscal 1948. That will give us a basis to go on. You have a total budget of \$37,528,000,000 and supplemental s.

Senator TARR. You gave us supplemental \$3,116,000,000. That is appropriations. How do you figure expenditures against those? That is what I would like to get.

Senator LYND. I think we ought to get first what the President recommended in all, supplemental, deficiency, and regular budget. And then figure against that what was actually appropriated, and then see whether the Republicans deserve credit for the economy or the Democrats. I do not believe there is very much economy in it.

Senator TARR. You said the President asked for \$37,500,000,000. He subsequently asked, you said, for supplementals of \$3,116,000,000. Does that include both the last session and the special session, when it was about a billion dollars, and also those made about for this current fiscal year? Is that right?

Mr. WEBB. Yes.

Senator, the thing that is causing me trouble—

Senator TARR. That is a total of \$40,600,000,000, whereas you are actually going to spend \$37,700,000,000. So we are going to spend \$3,000,000,000 less, it seems, than you estimated. Is that a correct statement?

Mr. WEBB. Senator, some of those are duplications. (See table VII, p. 77 and table IX, p. 82.) Then there is another item which I am having a little trouble with, and that is revisions of estimates under going programs which were not reflected by either Presidential action or congressional action, such as estimates of tile number of veterans who would take certain amounts of training.

Senator TARR. I can calculate this if you can reduce your Presidential supplemental things to expenditures. My criticism of the argument I just made to you is that the \$3,116,000,000, I take it, is supplemental appropriations requested, or is it supplemental expenditures requested?

Mr. WEBB. They are the appropriations.

Senator TARR. We have no figure to show what kind of expenditures that were contemplated in fiscal 1948. I think your statement, that Senator Millikin originally asked for, ought to show that as to each item broken down. I want to show how your expenditure budget for 1948 has been changed by all these things, your original estimate.

We have cut some of that down. You are going to spend \$37,700,000,000. I do not know how much less that is than your estimate of expenditures.

Mr. W. I have an estimate in my hand that starts with the figures of appropriations, requested in January 1947 submission, which was \$31,292,000,000. Now, with about 10 different changes, involving both congressional actions, changes in estimates, additional submissions by the President, we wind up with total requested appropriations of \$30,813,000,000.

Mr. Weldon Jones, the head of our Fiscal Division, can give you complete information about that statement, how it was made up and the items in it, if you would like them to, Senator.

Senator TARR. You are confusing appropriations with expenditures again. If we are going to stick on expenditures let us stick on expenditures, and reduce your information to that.

Mr. WEBB. I can give you the expenditure figure opposite each of the appropriations also.

The expenditures start with \$37,528,000,000 and end with \$37,727,000,000 an increase of \$200,000,000.

Senator **TAF**. It would have been more than that if we had approved everything you asked for, and estimated in your estimate of expenditures.

WEBB. That is right.

Senator **TAF**. That has been reduced. Who is responsible for reducing it?

(See table IX, p. 82.)

Senator **BYRD.** You have your first recommendation of \$37,528,000,000 of expenditure. Is that correct?

Mr. WEBB. That is right.

Senator **BYRD.** That is expenditure in fiscal 1948. Add to that all the further recommendations of the President, not for appropriations, but for expenditure in 1948.

Mr. WEBB. That is right.

Senator **BYRD.** Take the total of that and then take the total of appropriations and see what the difference is, all expenditures.

Mr. WEBB. I can give you that figure. Would you like it now?

Senator **BYRD.** Yes.

Mr. WEBB. On an expenditure basis the first 1948 budget submission was \$37,528,000,000. Under amendments to the budget through December, including both appropriations and contract authorizations, additional expenditures of \$1,044,000,000—

Senator **BYRD.** Is that what the President requested?

Mr. WEBB. Requested by the President. That is \$1,044,000,000.

Senator **TAF.** How could it be that? We had a billion dollars alone in the special session for the European temporary relief and the increase in German occupation. Those alone, without all the additional that came in the last session, and the more than half billion dollars requested in the President's budget.

Mr. WEBB. That is the next item on my statement. This first figure was made up, you understand, prior to the regular session. This was made up the 1st of January.

Senator **TAF.** I beg your pardon.

Mr. WEBB. I have here the second item anticipated supplemental recommendations to be submitted to the second session of the Congress, \$7,627,000,000.

Senator **BYRD.** Not for expenditure in fiscal 1948?

Mr. WEBB. Not entirely.

Senator **BYRD.** What we are trying to do is to find out what the President recommended for expenditures in fiscal 1948, what the Republican Congress did toward authorizing that, then we can determine if there has been any economy and if there is who deserves the credit for it.

Mr. WEBB. Let me give you that item on the expenditure basis, based on both the appropriations and contract authorizations.

Senator **BYRD.** Do not mix it up with appropriations and contract authorizations. That is very confusing to the public mind and to everybody else.

Mr. WEBB. Those were the President's submissions.

Senator **BYRD**. I understand. When he submitted it he said how much was going to be spent in fiscal 1948. That is the figure we want.

Mr. **WENN**. Add to the \$1,044,000,000 a figure of \$900,000,000.

Senator **LUCAS**. What is that for?

Mr. **WENN**. The entire fiscal year 1948.

Senator **BYRD**. All that money he recommended to be spent in fiscal 1948?

Mr. **WENN**. That is right.

Senator **BYRD**. Is that the total of it?

Mr. **WENN**. Yes sir; \$1,945,000,000. That is a total of-

Senator **TAYL**. There are some more in this session.

Senator **LUCAS**. Let us get the first session first.

Senator **BYRD**. What is there going to be authorized that the President asked to be expended in the fiscal year 1948 at this session?

Mr. **WENN**. To make this statement complete, I have to give you the revisions due to changes between fiscal years in program outlook.

The changes in the 1947 appropriations which

Senator **BYRD**. First let us get the recommendations for new expenditures in this present session to be expended in fiscal 1948. What is that?

The **CHAIRMAN**, Senator Byrd, would you mind if in addition to what you have asked for, they did the same thing for fiscal 1947 and '48 and as far as we have gone, fiscal 1949? In other words, the President's extension of requests for expenditures in those fiscal years after the original budget was submitted?

Mr. **WENN**. Right.

(The information requested is as follows:)

For 1947, see statement on page 76.

For 1948, see tables VII, VIII, and IX, pages 77, 79, and 82.

For 1949, supplemental estimates submitted to date are within the estimates included in the 1949 budget.

Senator **BREWSTER**. Mr. Chairman, before he leaves-I assume he will be back in the morning?

The **CHAIRMAN**. In the morning?

Senator **BREWSTER**. Illustrating the point which you have made as to certain elements of instability in this matter of estimates. I assume, even he does not claim omniscience. I have been fascinated by the variance in your estimates. I assume in the European situation they must be even more unstable because of the pressure.

I have before me your budget of a year ago, in which there was an actual appropriation of \$45,000,000 for airports. You estimated an expenditure of \$4,000,000. Now I have the current budget, in which you actually spent less than \$600,000 although you estimated

In other words, on an appropriation you estimated an expenditure of 10 percent, you actually realized an expenditure less than 20 percent of what you estimated.

Meanwhile, you have gone blithely ahead and have got now \$77,000,000 appropriated and you are asking for \$40,000,000 more. You estimate now for this current year, \$21,000,000, although a year ago you estimated \$30,000,000.

In other words, I think it simply illustrates that it is very difficult for you to anticipate what is going to happen in any given situation, certainly where any contingencies are involved.

Mr. **WEBB**. That is right. I would be glad to give you a statement on that airport program, Senator.

Senator **BREWSTER**. I would like to have your current estimate of what you actually expect now. You have estimated \$21,000,000, but I think you will find it is considerably less than that if you explore.

(The statement requested is as follows:)

Operating expenses for the first 7 months of the fiscal year 1948, indicate that the expenditure estimate of \$21,565,462 for the airport program contained in the 1948 budget is considerably in excess of the expenditures which may now be expected to materialize. This situation develops owing to a slower growth of the program than was originally anticipated. Because of the many uncertainties attending the program and in consequence of the delay brought about through the necessity of major project revisions in accordance with a substantial reduction in the budget requested for fiscal year 1948, the execution of grant agreements with sponsors has not proceeded as rapidly as was anticipated. Although grant agreements are being executed, at this time, at a rapidly accelerating rate the end result will be a substantial decrease in expenditures for fiscal year 1948. Reexamination of the expenditure estimates in the light of the foregoing facts indicates that probable expenditures during the current fiscal year will not exceed \$12,000,000.

Senator **LUCAS**. I think his estimates line about as close, perhaps, as some figures from Congress. But I would like to go to the floor, Mr. Chairman—

Senator **BREWSTER**. Not on revenue, at any rate.

The **CHAIRMAN**. I would like to ask two brief questions. They will excuse the witness.

We are about two-thirds the way through this present fiscal year. Are your expenditures which have been made so far more or less than two-thirds of those which you expect to make during the fiscal year?

Mr. **WEBB**. They are less than the two-thirds.

The **CHAIRMAN**. Substantially less?

Mr. **WEBB**. Yes.

The **CHAIRMAN**. How much?

Mr. **WEBB**. Several billion dollars.

The **CHAIRMAN**. Do you expect to make that up between now and the end of the fiscal year?

Mr. **WEBB**. Yes. There will be additional expenditures that occur in the latter part of the year, certain interest payments and other things fall more heavily in the latter part of the year.

The **CHAIRMAN**. Let me ask you this: In figuring your expenditures what level of income do you adopt?

Mr. **WEBB**. They are figured on different bases, Senator. The general level that was used in the budget were the prices of August 1947.

The **CHAIRMAN**. Those were high prices?

Mr. **WEBB**. Yes, although I believe they have increased some since then.

The **CHAIRMAN**. Have they not reduced considerably in some areas?

Mr. **WEBB**. I do not believe they have gone as far back as August.

The **CHAIRMAN**. So whatever the level that you take, that also is subject to the fluctuations which occur after that.

Mr. **WEBB**. That is right. I pointed that out.

The **CHAIRMAN**. In other words, if prices were to go down you would not have to spend so much.

Mr. **WEBB**. For things you buy.

The CHAIRMAN. For the same objectives.

Mr. WEBB. But certain other items in the budget would increase and tend to offset those.

The CHAIRMAN. That would depend entirely as to what the price level is on those items.

Mr. WEBB. Things like farm-price support.

The CHAIRMAN. If you had a drastic price recession you would not have to spend so much to accomplish the same.

Mr. WEBB. But some other problems in the Government would increase and tend to offset those.

The CHAIRMAN. I have no doubt about that. I am simply talking about buying goods. If the cost goes down, you do not have to pay as much money for the same goods. Is that not right?

Mr. WEBB. That is right.

The CHAIRMAN. If it goes up you have to pay more. That is quite evident.

Senator BREWSTER. Can the gentleman find any reasons for optimism? You gave a rather pessimistic view. There must be some things in your vast range of knowledge that are encouraging. You can try tomorrow morning to dig up one or two of those.

General Lord, who was your distinguished predecessor in the previous liquidation of war, was also helpful in that direction as to how we could solve that problem. Your tendency seems to be to find all the reasons why it is utterly impossible and I am sure you want to be as helpful as you can.

Mr. WEBB. I was going to say, Senator, that having devoted a great deal of effort to reducing departmental requests by some \$7,000,000,000 before they came to you I would hope you would take that into consideration in considering whether or not I have been easy.

Senator BREWSTER. We appreciate that, all right.

Mr. WEBB. They used to tell me about General Lord—that he had a nice way of doing business. If somebody wanted to see him, he would say, "Find out what they want, and tell them they cannot have it." I have not done that in this budget.

Senator BREWSTER. Perhaps, we need to find another General Lord.

The CHAIRMAN. If there are no further questions which the members of the committee wish to ask, we will excuse the witness.

Senator BYRD. I have one.

I would like to have Mr. Webb be prepared to answer tomorrow as to the budget for 1950. There are a number of references here as to the increase between the budget of 1950 over 1949.

I would like to have him answer specifically as to what part of the \$7,000,000,000 which the President did not approve the requests—what part of that was for military purposes.

Mr. WEBB. I will be glad to do that.

Senator, I have one problem, and that is that I am to appear before the Senate Appropriations Committee tomorrow morning.

The CHAIRMAN. Would you be content to have that put in the record?

Senator BYRD. I would like to examine him on it if he is going to appear again before the committee.

The CHAIRMAN. We had no intention of calling him again unless you wish him called.

Will you be content with that? Senator **BYRD**. That will be all right. I can get it by correspondence.

The CHAIRMAN. And as to the 1950 expenditures, that especially will be completely in accord with the diversions of Congress.

Mr. WEBB. Yes, sir.

The CHAIRMAN. So that these gloomy forecasts, I hope, may not realize.

Mr. WEBB. It is our common experience in trying to hold expenditures down, I would also like to have you include in your

notation for the record the precise figures for the European program concerned with shipping. I have had a great deal of difficulty in finding out what was contemplated in that whole field.

Mr. WEBB. I would be glad to do that.

(The information requested is as follows:)

ESTIMATED SHIPPING COSTS UNDER ERP PROGRAM

1. ESTIMATE OF COST INCLUDED IN STATE DEPARTMENT SUBMISSION

The ERP program includes \$1,700,000,000 for the dollar cost of shipping during the 4-year period. This cost is broken down by year and by type of cargo, as follows:

Fiscal year	Dry cargo	Tanker	Total
1949.....	\$500,000,000	770,000,000	\$1,270,000,000
1950.....	200,000,000	100,000,000	300,000,000
1951.....	230,000,000	130,000,000	360,000,000
1952.....	130,000,000	180,000,000	310,000,000
Total.....	1,220,000,000	480,000,000	1,700,000,000

As emphasized in the formal submission to Congress, these estimates are based on a number of variable factors, principal among which are the level of ocean freight rates, and the overall level of traffic under ERP. The above data assume the level of freight rates in effect as of July 1, 1947. There has since been some decline in rates; if the present level continues, shipping costs for the program would be somewhat lower than estimated above. However, there is no assurance that the present level will actually continue in effect. In fact, there is a strong possibility that rates will rise when shipments under ERP commence. In volume, unless the requested authority to make surplus ships available to foreign operators is granted, there is no basis at present for revising the estimates of total commodity traffic upon which the above cost data are based.

The above estimates also assumed the sale to the European nations of the 200 surplus vessels requested by them in their Paris report. The State Department has estimated that, in the event that such transfer is not effected, the dollar cost shown above would be increased by about \$300,000,000, as indicated below:

	Millions of dollars
Additional dollar freight: Cost (gross)	432
Less offsetting dollar costs involved in foreign purchase and operation:	
(a) Down payment for vessels.....	32
(b) Annual installments.....	14
(c) Dollar expenditures for port charges, etc.....	86
Total offset.....	132
Additional dollar freight cost (net).....	300

It should be noted that some vessels have already been transferred since submission of the ERP estimates. Recent information from the European nations indicates that their present requirement would call for the purchase of only about 100 additional vessels.

II. SAVINGS POSSIBLE THROUGH CHARTER TO FOREIGN OPERATORS

In addition to the 200 vessels assumed to be sold to the European nations, the ERP program recommended to Congress proposes the transfer by charter of not to exceed 300 surplus vessels. The dollar savings made possible by the transfer of this number of vessels has been estimated by the State Department at about \$240,000,000, as indicated below:

	of dollars
Savings in dollar freight charges (gross)-----	338
Less dollar operating costs (port charges, etc.)-----	0
Savings (net)-----	241

Thus, the net dollar shipping cost under ERP, assuming both sale and charter as indicated above, would be allowed.

Total dollar	None
--------------	-----------------

Less savings through charter of 300 vessels
cost with

The CHAIRMAN. We will adjourn until 10 o'clock tomorrow morning.
(Thereupon, at 12:05 p. m., the committee adjourned, to reconvene Tuesday, March 10, 1948 at 9 a. m.)

REDUCTION OF INDIVIDUAL INCOME TAXES

TUESDAY, MARCH 2, 1948

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

The committee met at 10 a. m., pursuant to adjournment, in room 312 of the Senate Office Building, Senator Eugene D. Millikin (chairman of the committee) presiding.

Present: Senators Millikin (chairman of the committee), Brewster, Bushfield, Hawkes, Martin, George, Barkley, Connally, and Lucas.

The CHAIRMAN. The hearing will collie to order.

The first witness is Mr. Hanes.

Mr. Hanes, will you please come forward?

Will you give your full name and occupation?

STATEMENT OF JOHN W. HANES, FORMER UNDER SECRETARY OF THE UNITED STATES TREASURY, NEW YORK, N. Y.

Mr. HANES. My name is John W. Hanes. My address is 1 Broadway, New York City.

The CHAIRMAN. You were formerly connected with the United States Treasury.

Mr. HANES. I was; yes, sir.

The CHAIRMAN. What was your position with the Treasury?

Mr. HANES. I was First Assistant Secretary and later Under Secretary of the Treasury.

The CHAIRMAN. Proceed, please, Mr. Hanes.

Mr. HANES. Mr. Chairman, I am appearing here today in response to a request from the chairman of your committee, and the views I express are my own.

Senator BARKLEY. You used to be here with the Treasury, but what is your present connection?

Mr. HANES. I am at the present time chairman of the finance committee of the United States Lines Co.

Senator BARKLEY. Thank you.

Mr. HANES. First, I would like to mention a matter which concerns me deeply. This is the general confusion that is evident in the public mind concerning the tax-reduction bill now before your committee for consideration. The impression has been spread that, for the most part, the individual income-tax payer will go scot free under this bill and that all income-tax payers are being given huge tax reductions.

This bill has been labeled as a major tax reduction measure, but nobody has brought out the fact that the tax reductions proposed

will, in fact, not go very far toward bringing our people back to anywhere near a peacetime basis. Admittedly, we may never return to such a basis, but I believe it would be worth while to examine the facts for a moment and see just how small a step toward prewar tax levels this bill brings us.

For instance, take as an example a married man, with two dependents, who has a net income before personal exemptions of \$15,000. In 1939 his tax was \$831. By 1941 his tax had been tripled to \$2,475. Through successive increases in 1942 and 1943 his tax was brought up to a peak of \$4,265.

Under the present bill his tax would be \$2,320, or about equal to his 1941 tax and three times his 1939 tax. When we consider that inflation has lowered the value of the dollar by at least 40 percent during the war and postwar period, we see that the tax reductions proposed in H. R. 4700 will do very little toward restoring the living standard of a man with the \$15,000 income to the prewar level, or even to the level of the early war years.

I am attaching hereto a table, exhibit A, which gives the effect of these changes for a \$5,000, \$10,000, and \$15,000 man.

(The table mentioned will be found on p. 100.)

In considering this problem of tax reduction, naturally the first question which confronts us is, "Can we afford a tax cut?" Last spring when Congress was considering the question of tax reduction, I wrote a letter to your chairman, Senator Millikin, and to Senator George, expressing my belief that the Federal Government would show a very substantial surplus for the 18-month period, January 1, 1947, to June 30, 1948. You may recall that at that time the Treasury was estimating a deficit of 2.3 billion dollars for the year ending June 30, 1947, and a small surplus of 200 million dollars for the year ending June 30, 1948.

I predicated my statement on the assumption that the Congress would reduce Government expenditures materially for the fiscal year 1948. On that assumption I stated my belief that the surplus for the 18 months beginning January 1947 and going through fiscal 1948 would be between \$9,000,000 and \$11,000,000. The President has since declared that Congress reduced expenditures by \$1,500,000,000, a figure which, for sound reasons, has been disputed in many quarters. The President also stated that total expenditures for the current fiscal year will be higher than originally estimated in the Budget document.

Nevertheless, the Treasury has three times found it necessary to revise their revenue estimates upward. The actual result was a surplus of \$750,000,000 instead of a deficit in the last fiscal year and the anticipated surplus for the current fiscal year has now been increased from \$200,000,000 to \$7,500,000,000. It seems that this estimate is also too low.

Thus the officially estimated surplus for the two fiscal years—last year and the current year—will total \$8,250,000,000. This is far above the amounts I would have expected under the high expenditure levels of this year and last. My forecast, however, was far more accurate than the figures used by the President as a basis for his two vetoes of last year's tax bills passed by large majorities in both Houses.

The size of the errors in Treasury estimates does not leave room for much faith in the estimates now put forward by the administration for the current fiscal year and for the fiscal year 1949.

At the President's budget seminar in January, Secretary Snyder is reported to have said that the revenue calculations were based on a level of personal incomes of \$192,000,000,000. Later, the Secretary stated that the estimates were based on personal incomes of "about \$200,000,000,000." According to the reports of the Department of Commerce, personal income in the third quarter of calendar 1947, the first quarter of the present fiscal year, was at an annual rate of \$200,400,000,000. The rate in October was \$201,400,000,000, and in November it was \$201,900,000,000. On February 12, the Department of Commerce issued a statement giving the December figure as \$209,700,000,000.

These figures indicate that the Treasury estimate for fiscal 1949 is once more too low and that we may expect a surplus larger even than the estimated \$7,500,000,000. In fact, at the hearings before the Ways and Means Committee, a Treasury staff member stated that, if personal incomes totaled \$205,000,000,000 for the year, we might expect an increase in revenues of \$1,100,000,000 (p. 91).

The evidence since December indicates that this level of incomes is still being maintained.

For instance, in the budget, the President estimated that income taxes withheld by employers would increase this year over last year by 13 percent. The increase up to December 31, 1947, was 17 percent. Therefore, the increase in the last 6 months of this fiscal year would be only 16 percent to meet the President's figure.

Senator BARKLEY. Would it disturb you, Mr. HANES, if I asked a question there?

Mr. HANES. No, sir.

Senator BARKLEY. In connection with that, you have probably seen the statement issued within the last 2 weeks by the Department of Commerce that the national income for last year was \$197,000,000,000.

Mr. HANES. Yes, sir.

Senator BARKLEY. How do you reconcile that?

Mr. HANES. That is the average.

Senator BARKLEY. You are speaking now of what would happen if all the months were as good as December?

Mr. HANES. That is right. I think the Department gives a figure by months, and I can give it to you if you like.

Senator BARKLEY. I do not care about it by months.

Mr. HANES. The average figure was \$197,000,000,000, and the last figure in December was \$209,000,000,000, which, of course, was about \$10,000,000,000 higher than the average for the year.

The CHAIRMAN. Is it not also correct, Mr. HANES, that, in estimating the revenue for fiscal 1949, the trend of the last few months of 1948 is a very highly important factor?

Mr. HANES. Yes, sir; very indicative.

However, the Treasury statement of February 26, the latest available, shows that the increase since January 1 over the comparable period last year is thus far actually 15½ percent. In February income-tax withholding collections are running 17 percent ahead of February of last year.

On January 31, at the end of the first 7 months of the current fiscal year, net budget receipts were nearly $1\frac{1}{4}$ billion dollars ahead of the corresponding period last year. Monthly receipts from withholding taxes during this 7-month period have averaged nearly 120 million dollars more each month than last year. Knowing that the March payments will reflect the increased income of corporations during 1947 over 1946, and will thus exceed last year's payments, we may confidently expect that revenues in the current fiscal year will substantially exceed the President's estimates.

With consideration of these factors, it seems evident to me that the total receipts for the fiscal year 1948 will reach 47.5 billion dollars. Under the present expenditure estimate of 37.7 billion dollars, this should leave a surplus for the current year of 9.8 billion dollars.

The President estimated revenues for the next fiscal year, 1949, at 44.5 billion dollars and the surplus at 4.8 billion dollars. The staff of the joint committee, in the House Ways and Means Committee report on H. R. 4790, raised this estimate to 47.3 billion dollars, a figure which seems conservative. The seasons given in the report appear to me to be sound, and there is no question in my mind that this revenue level will be reached or even exceeded. Thus the 1949 surplus would be 7.6 billion dollars, if we assume that the President's expenditure proposals remain unchanged. But the Congress has now voted to hold expenditures in the next fiscal year to 37.2 billion dollars, a reduction of 2 billion dollars below the President's figure. If the Congress should succeed in this intention, the surplus for next year would be 10.1 billion dollars.

Within these surplus figures, a total of 19.9 billion dollars for the two fiscal years, there is evidently ample room for tax reduction. The question of whether we can afford a tax cut must thus be answered with an emphatic "yes."

Last spring I stated that the general feeling that the debt must be reduced during this period of prosperous business was most wholesome. I agreed with that opinion at that time, and I am still in agreement. However, surpluses of the size that are now in prospect mean that the Government is taxing the people far beyond its needs. I believe strongly that there is sufficient latitude, not only for debt reduction exceeding any amounts anticipated by the administration last year, but for substantial tax reduction.

Nor does it seem unreasonable to expect that the Congress can wisely and safely reduce expenditures in the next fiscal year. The President's budget contains over 5.7 billion dollars of proposed spending which the Congress has not yet authorized. This involves programs on which Congress has not yet expressed its views and, consequently, the opportunity for reducing expenditures is much greater than it was last year. A cut of $2\frac{1}{2}$ billion dollars will still leave the budget at a level which amply takes into account the uncertainties in the world situation and America's responsibilities both at home and abroad.

In the past few weeks the drop in commodity prices has naturally raised a question of whether we are in for a period of slowing down in business—whether this drop was really the first sign of a deflation. I would like to make a few observations on this point.

First, the size of these price drops and their effect on the rest of the economy do not warrant drastically revised estimates of Federal revenues, particularly for the current fiscal year ending June 30.

Second, so far as the next fiscal year is concerned, if there is to be a slowing down of business, then there is room within the surplus to curtail somewhat the large amounts now available for debt reduction and thus provide sufficient leeway for tax reduction.

Third, the most reliable business economists are pretty well agreed that the pattern for 1948 is fairly well set.

The CHAIRMAN. Is that fiscal or calendar year?

Mr. HANES. Calendar year 1948, I am speaking of.

The high volume of business activity and its continuation are largely dependent upon capital expenditures by private industry, and all indications point to about the same amount to be spent in 1948 as in 1947.

In this connection the proposal of your chairman, approved by the Foreign Relations Committee, to set aside \$3 000,000,000 of the 1948 surplus, to be earmarked for European expenditures in the next fiscal year, provides an additional safety factor or margin which would insure that debt reduction will not be neglected next year.

Again looking at the 1949 picture, it may be pertinent for me to quote the statement of Secretary Snyder before the House Ways and Means Committee last spring—hearings on H. R. 1, pages 18-19:

If, however, at a future date business should be operating at less than capacity, I believe that it could be stimulated by tax reductions. Such tax reductions should be so designed as both to stimulate business incentives and to increase mass purchasing power on which business prosperity ultimately depends. I believe, therefore, that in any such future revision of the tax system consideration should be given both to decreasing tax rates and to increasing personal exemptions in a manner calculated to distribute the benefits equitably.

I believe that H. R. 4790 is precisely the kind of program that meets these requirements of Secretary Snyder. I submit further that now is exactly the right time for stimulating business incentives.

I know, from my own observation and experience, that the present tax laws preclude individuals from saving amounts necessary to flow into business to keep the economic ball rolling. I have yet to see more convincing evidence of this fact than the data on liquid savings prepared by the Securities and Exchange Commission periodically.

According to the latest quarterly survey of the volume and composition of individual savings, the liquid savings by individuals during the third quarter of 1947 amounted to approximately 2.9 billion dollars, and with adjustments for increased inventories of unincorporated business the amount would be raised to 3.1 billion dollars.

What form did these savings take? Principally, individuals increased their holdings of cash and deposits by 2.5 billion dollars. They increased their equity in private and in Government insurance by about 1.6 billion dollars; and there were smaller increases in their investments in savings and loans associations.

As offsets, individuals increased their mortgage indebtedness on nonfarm residences by 1.1 billion dollars and reduced their holdings in Government securities to the extent of 200 million dollars. I quote from the study the following very significant conclusion:

Individuals' holdings of State and local government securities increased by \$100,000,000, while their equity in corporate and other securities increased by \$200,000,000.

In other words, in a period when liquid savings ran at the high rate of \$3,000,000,000 quarterly individuals added only \$200,000,000 to their corporate securities holdings.

The evidence in recent years is even more startling. We find that in the 8-year period 1940-47, individuals actually reduced their holdings of corporate securities by 1.3 billion dollars net. In the same period, while individuals were cutting down their corporate security holdings, liquid savings increased in the astronomical amount of \$182,000,000,000. If an proof is needed that current tax laws are preventing savings of the type which would be invested in equities, here it is. This is the time of the year when corporations in large number publish their annual reports.

The CHAIRMAN. Mr. Hanes, is it not a fact that numerous companies in this country have wanted to float equity securities and have been unable to do so and have been driven to taking on indebtedness?

Mr. HANES. That is an exact fact, Senator, and I understand that there have been a great many issues registered with the Securities and Exchange Commission for sale to the public that have been withdrawn.

I do not have the exact figure, but I think it would be interesting for the committee to have it.

The CHAIRMAN. We will have data on that later.

That is the documentary evidence of what you are talking about?

Mr. HANES. Exactly. I think it is a very important figure to have.

I wish that tax experts of the Treasury and others would examine these reports, for they represent the raw material of American enterprise. Analysis of these annual reports reveal how a business actually functions and why an increase in profits tells only part of the story.

Concretely, in a period of business expansion—and the problem is aggravated when the price level is rising—profits are rarely reflected in a corresponding increase in the ratio of cash to current liabilities. The amounts provided through undistributed earnings and depreciation fall far short of the amounts that have to be expended for increased accounts receivable, inventories and plant expansion. This means that funds have to be provided from outside sources, either bank loans or the sale of bonds or equity securities.

Since the banking authorities are concerned with the increase in bank loans, and business itself hesitates to reduce the ratio of net worth to debt, the outlet through the stock market is of special importance. The deplorable state of the stock market explains in part why corporations have paid what seems to be a niggardly part of their earnings in dividends. As stated in the annual report of one large company—Burlington Mills annual report:

With the capital markets showing less and less absorption power at reasonable values, there will be no source of funds for renewals and modernization unless they are arbitrarily set aside from profits, and no prudent management could afford to plan otherwise.

Thus we have a vicious circle. Management is caught in a dilemma. When the demand for its products calls for plant expansion it finds that the tax laws place obstacles in its way in attracting additional funds. On the other hand if inability to expand results in unemployment, business is attacked for not furnishing adequate employment.

Here, Mr. Chairman, I would like to call your attention to the exhibit which is marked "Exhibit B" attached to my statement, which is an editorial from the New York Times, dated January 21, 1948, entitled "Capital, and Mr. Harriman."

I call your attention especially to the last sentence of that editorial, because it clarifies this issue better than anything I have seen up to date.

With your permission, I would like to have that inserted in the record.

The Chairman, It will be inserted at this point.

(The editorial is as follows:)

EXHIBIT B

[Editorial from the New York Times, January 21, 1948]

CAPITAL, AND MR. HARRIMAN

Testifying before the House Ways and Means Committee in opposition to Republican tax-reduction plans, W. Averell Harriman, Secretary of Commerce, argued that it would be economically dangerous at present to divert capital into private investment at a rate higher than that now prevailing. To increase that rate, said he, would necessitate a "painful readjustment" later.

Now, it may well be true that industry can raise funds to cover the replacement and expansion needs regarded as desirable under present inflationary conditions. It is by no means as clear that it can raise such funds on terms which are consistent with the needs of a stable economy. In 1940 security issues floated in the investment market for purposes of raising new capital amounted to 3.5 billion dollars. The total included 2 billion dollars in bonds and notes, One and five tenths billion dollars in common and preferred shares. That is a fairly healthy ratio of debt to equity capital. But in the first 9 months of 1947, while the rate of financing was almost identical with that of 1940, the pattern showed a pronounced change. In the latter period 2.5 billion dollars of the new issues took the form of borrowing and only 1 billion dollars equity financing. In other words, where corporations had found it necessary to raise but 57 percent of their new capital through borrowing, in the first 9 months of 1947 the percentage has risen to around 71 percent.

What do these figures suggest? They suggest, first, that in boom times, such as the present, corporations do not cease expanding because of a shortage of risk capital; they merely shift to less desirable methods—methods which, if long continued, would almost certainly make the "painful adjustment" of which Mr. Harriman speaks vastly more serious than otherwise. They suggest, second, that we have already reached the saturation point so far as financing through equity capital is concerned. Mr. Harriman, as a matter of fact, admits that the trend toward financing through credit is an unhealthy one, but observes that it has "not yet reached the danger point."

Very well. Let us agree, for purposes of argument, with Mr. Harriman's diagnosis that although the patient is sick its condition is not yet critical. What is to be said, then, for Mr. Harriman's going beyond the point of defending the present tax structure and supporting the President's proposal to add 3.2 billion dollars to the corporate tax burden?

On the face of figures which he himself presented your Ways and Means Committee this is a preposterous suggestion. Those figures are an analysis of the methods by which corporations financed their expenditures in 1947. The expenditures included 14.5 billion dollars for plant and equipment, 7 billion dollars for inventory enlargement, and 5 billion dollars for added trade receivables, a total of 20.5 billion dollars. Of this 20.5 billion dollars no less than 15 billion dollars was met out of retained profits. Of the remainder 4 billion dollars was raised through new issues, 3.5 billion dollars through bank loans and 3 billion through trade and other "payables." In other words, the chief source of financing—and almost the only source of legitimate risk capital—was retained profits. Yet while he himself admits that too much risk investment is already being financed through the medium of nonrisk securities and other forms of borrowing, the Secretary of Commerce blandly approves the President's plan to "soak corporate profits," and thus deal a crippling blow to what is today almost the sole source of business capital. It simply doesn't make sense.

The **CHAIRMAN**. Is the sentence to which you refer the one starting with the word "yet"?

Mr. **HANES**. It starts with "in other words" and reads:

In other words, the chief source of ~~financing~~—and almost the only source of legitimate risk ~~capital~~—~~was~~ retained profits. Yet, while he himself admits that too much risk investment ~~is~~ already being financed through the medium of ~~nonrisk~~ securities and other forms of borrowing, the Secretary of Commerce ~~blantly~~ approves the President's plan to "soak corporate profits," and thus deal a crippling blow to what ~~is~~ today almost the sole source of business capital. It simply doesn't make sense.

Mr. Chairman, the time has come when it is the plain duty of every patriotic American to throw aside the superficial thinking that is destroying that way of life which created this vast productive machine of ours. Tax laws which steal from the individual the fruits of his labor will produce stagnation in this country just as it has done in England, France, Italy, and elsewhere. Socialism and capitalism cannot live together, and our obligations are so great that we cannot afford any further experiments in socialism. There is no country to which we can turn for loans when these experiments fail.

As I understand it, the position of the administration is that tax receipts over-all should not be reduced at this time. If a change is made in the tax structure, the **Treasury** argues, relief should be concentrated in the lower income groups and offset by a corresponding increase in corporate taxes.

The **CHAIRMAN**. Mr. Hanes, I might suggest that that is hardly the effect of the administration proposal. The compensatory excess-profits tax will not commence to compensate for a year or two after the effectiveness of any bill of that kind.

Mr. **HANES**. That is right.

The **CHAIRMAN**. So there is no compensatory effect at the time when under the arguments by the administration there should be such an effect?

Mr. **HANES**. That is exactly right. In fact, tax from corporations is in some cases 15 months away from payments.

The **CHAIRMAN**. That is right.

Mr. **HANES**. The President, in his message on the state of the Union, in harmony with these conclusions, requested Congress to reduce individual incomes taxes by \$40 for each member of the family and to lift corporate taxes by \$3,200,000,000 to compensate for this reduction.

The doctrine is fallacious. In my opinion, substantial tax reduction would revitalize risk capital, it will help maintain employment, and through increased production it will lower the cost of goods and services to the consumer. It is utterly inconsistent, in my judgment, to ask for higher production and at the same time discourage business expenditure.

A lower scale of Government spending and the application of the resulting savings and a portion of the current surpluses to tax reduction can be our best insurance against a downward deflationary spiral or a depression. Lower taxes will create savings with which to invest and assume business risks, which, in turn, will encourage labor and management to expand and to increase production. Both in the near future and in the long run, greater production is our strongest bulwark of defense against inflationary pressure on the one hand, and against deflation and a lower standard of living on the other.

The House Ways and Means Committee has made an excellent statement on H. R. 4790, and I would like to quote one paragraph from their report:

In the opinion of your committee production must be the ultimate answer both to the immediate inflationary problem and the long run goal of achieving a higher standard of living. Increased production requires the wholehearted cooperation of all segments of our economy. To accomplish this goal the productivity of labor must be increased, the initiative of our business managers must be stimulated, and profits after taxes must be of sufficient size to attract investors into risk-taking enterprise. Your committee believes that the present high, wartime-tax rates represent one of the chief obstructions to the achievement of this higher level of production.

This is a statement which deserves wholehearted endorsement on a nonpartisan basis.

The CHAIRMAN. Mr. Hanes, with the exception of the editorial to which you refer, I assume you do not now care to go over the rest of the attached material?

Mr. HANES. I believe it is self-explanatory, except for the editorial from the New York Herald Tribune which I also attach there as exhibit C.

That was an editorial entitled "Venture Capital," which appeared on March 1 1948.

I would like to have that incorporated in the record if you would, because I think it is very pertinent to this question so uppermost in my mind at the moment, which is venture capital.

The CHAIRMAN. It will be put in the record.
(The editorial is as follows:)

EXHIBIT C

[Editorial from New York Herald Tribune, March 1, 1948]

VENTURE CAPITAL

Financial markets are troubled by a peculiar problem which appears to have a decided bearing upon our national economic progress. The problem is an inadequate supply of venture or risk capital. New issues of debt securities can be marketed readily enough with institutions, such as insurance companies and savings banks the principal buyers. But common and preferred stocks, which the institutions usually are not permitted by state boards to buy, are not in demand. The market for outstanding stocks, which are the venture securities indicating ownership of enterprises, drags along despite dividend returns which are higher than average and corporate earnings which in many instances are at record levels.

As financial leaders and corporate managers are proclaiming with increasing emphasis, it is venture capital—the willingness to take risks—that fostered the inception and growth of our giant industries. The return on such capital is statistically adequate just now, and yet it does not venture. This makes it necessary for many companies to borrow for the development of improved processes and new products, when corporate financial structures suggest that a greater use of equity money, which shares in the risks and profits of an enterprise, would be advisable.

Many competent observers have concluded that this situation is due to the incidence of Federal taxes, which fall with exceptional severity upon those with large incomes who normally are the buyers of stocks. Emil Schram, president of the New York Stock Exchange, warns that the task of financing business may have to be taken over by the Federal Government under the current tax schedules. He calls, accordingly, for such drastic changes as a reduction of individual income surtaxes to a maximum rate of 50 percent and a reduction of the maximum tax on long-term capital gains to 10 percent from 25 percent.

Although the point may be raised that those who make these analyses and recommendations have a tax ax to grind, the contentions seem reasonable and cannot be dismissed lightly. They do run up against some stubborn facts, however, which suggest additional inquiry. Just 2 years ago, for instance, a booming

market for new stock Issues flourished under at least equally adverse taxation. Moreover, money available today for investment and other purposes adds up to many times the total of credit and ready funds, which financed the bubble that burst in 1929. Perhaps a survey by competent economists could clarify these matters.

EXHIBIT A

Individual income-tax liability, income years 1939-46 and under H. R. 7490

MARRIED PERSON-TWO DEPENDENTS

	Net income after deductions but before personal exemptions			Net income after deductions but before personal exemptions		
1939	\$ 43	\$831	1943	\$730	2,208	\$1,207
1940	75	1,118	1944	755	2,245	4,265
1941	271	2,475	1945	589	1,862	3,639
1942	52	3,758	H. R. 4790	288	2,108	2,320

1 Includes defense tax.
 2 Tax liabilities for the years 1942 and 1943 are unadjusted for transition to current payment basis.
 3 Includes net Victory tax. Computed by assuming that deductions are 10 percent of Victory tax net income; i. e., that Victory tax net income is ten-ninths of selected net income.
 4 Assumes entire income earned by one spouse.

Source: 1939-46, Treasury Department Treasury Bulletin, February 1947, p. A-10; H. R. 7490, House of Representatives, 80th Cong., 2d sess., report No. 1274 to accompany H. R. 4790.

The CHAIRMAN. Are there any questions?
 Senator MARTIN. Mr. Hanes, from your experience, how large can the tax take be so that men will still invest in what we call risk capital?
 Mr. HANES, Senator, that is a pretty hard question to answer categorically.

I would say this: In the first place, the tax rates have got to be of such a level that it will first of all permit savings.
 I think we are all agreed that at this particular moment and at the present rate of taxes for the higher income groups, it is almost impossible to have any savings left, or any surplus, after meeting your tax bill. It just does not exist.

Take, for instance, a man with what we used to think was a high income of \$25,000 a year. Your 50 percent bracket begins at \$18,000. When you subtract the loss of purchasing power of the dollar compared with the 1939 dollar, you are really taxing that man 80 percent of his earnings and not 50 percent because you have subtracted from him the purchasing power to such an extent that it leaves him with no savings.

The CHAIRMAN. Mr. Hanes, might I interrupt to say, would it not be correct that the \$25,000 man of 1939 would have an even higher net, because of tax rates, of take-home income return today of several times that amount?

Mr. HANES. That is right.

The CHAIRMAN. I later on will put the exact figures in the record, but, as I recall, it is several times that amount and that does not take into account the decreasing value of the dollar.

Is that correct?

Mr. HANES. That is correct. We have taken no account of that since the tax rise began in 1929.

The **CHAIRMAN**. Would it not be a correct answer to the question which Senator Martin has made to you that your whole thesis showing that the sources of risk capital have dried up indicates that we have reached the levels to which Senator Martin is curious about?

Mr. **HANES**. I think the stock market itself is an indication of that.

There was a very interesting article published in one of the magazines, I think Time magazine, about the last part of **January**, showing the comparative values of prices of stocks on the New York **Stock Exchange**.

In many cases, good, sound securities were selling there on the exchange at two and three and four times their earning capacity.

That, added to the other evidence which you have of the accumulation of equity capital which is available for the market but no market is available to absorb it, it certainly is an indication that there are no savings and the tax laws are handicapping our economy to a very marked extent at this time.

Senator **MARTIN**. Mr. Chairman, I would like to make this observation for the benefit of the committee.

A year or two ago the **Heinz Co.** which is, as you know, a **Pittsburgh** concern, and a world-wide concern, offered stock to the public.

The new president, as you know, is a very young man and a great number of folks said: "Well, he has not been able to follow with the same ability as his father and grandfather, because for 75 years it was a concern owned by the family."

Some of us went into it, and we found that the taxes had been so large that they could not make the expansion that their business required without getting new capital, and then they gave the public an opportunity to buy.

That, of course, is fine, but a lot of us were very much worried that probably there was a fine concern getting into financial difficulties.

But it was not. Its sales had increased all over the world, and to keep up with those sales, it was necessary to expand, and they could not expand by the old-fashioned method of plowing back in.

Mr. **HANES**. Senator, you have another glaring example in your State of the same sore of thing that I am talking about, and that is the **Gulf Oil Co.**

Senator **MARTIN**. That is right.

Mr. **HANES**. They needed, as most oil companies do now, a terrific amount of additional capital; and when they got ready to get that capital, they offered rights to their stockholders.

In the old days, when you offered rights to a stockholder, that was always considered a plum and everybody was delighted when it was offered. They would be delighted today if they had savings to invest if the **Gulf Oil Co.** should offer them rights to subscribe at several points below the then market.

The immediate effect of that offer was that **Gulf Oil Co.** stock fell \$7 on the New York Exchange, and that was an immediate indication that the stockholder felt it was not a right of which he could avail himself.

That was a glaring case of the evidence.

The **CHAIRMAN**. Senator **Bushfield**?

Senator **BUSHFIELD**. No questions.

The **CHAIRMAN**. Senator **George**?

Senator **GEORGE**. No questions.

Senator **BARKLEY**. Mr. Hanes, was that drop of \$7 a share due altogether to the announcement that rights would be issued, or to the fact that, connected with that, the amount of stock outstanding would be multiplied and therefore the return might be smaller on each share?

Mr. **HANES**. No, Senator. I think the answer was completely as I stated it first, because even though there would be more shares outstanding that money was going to be invested in highly productive return. So there would not be any dilution of the per share earnings ostensibly, or the management would not have been willing to invest the money. That must be the obvious conclusion.

There was a further drop in the value of the shares on the second day. I do not quite remember the details but I know it was a shock-
ing thing.

Senator **BARKLEY**. Aside from that, it has been matter of observation over a long period of years that when any company announces that it is going to increase its outstanding stock, the immediate effect is to produce a drop in the value of stocks already issued.

Mr. **HANES**. That might be true, Senator, if you were paying a stock dividend by increasing your shares.

Senator **GEORGE**. If you were splitting the stock.

Mr. **HANES**. If you were splitting the stock, and adding to the shares without adding to the value, that might be true.

But in this case, it was not a case of splitting or of giving stock dividends to the shareholder. It was a question of reinvesting capital in the business which was going to be highly productive, thus not diluting the per share earnings.

That kind of financing in the past, Senator, I think you will find, has resulted in an increase in value of shares rather than a falling off. In other words, those rights were considered to be of great value and sold in open market at a real value.

* Senator **GEORGE**. In this case, the stockholders did not have the cash.

Mr. **HANES**. I would assume that to be the answer.

Senator **GEORGE**. Not available for that purpose.

Mr. **HANES**. They said, "Here, we can sell the rights today and get some real cash for them."

So they proceeded to sell the rights. Indeed, the larger stockholders sold all their rights.

Senator **BARKLEY**. Do we understand from your statement that you advocate the House bill and the reduction of taxes of \$6,500,000,000 carried in it?

Mr. **HANES**. I beg your pardon, Senator?

Senator **BARKLEY**. Do we understand from your statement that you are advocating the passage of the House bill carrying a \$6,500,000,000 tax reduction?

Mr. **HANES**. I am advocating passage of a tax bill, Senator, with a good, healthy reduction in it, and I am willing to leave the amount of that reduction to the good judgment of this committee and the House Ways and Means Committee.

Senator **BARKLEY**. The House bill carries that amount.

Mr. **HANES**. That is right.

Senator **BARKLEY**. Assuming that sort of bill were enacted, have you any information that would enlighten us as to what proportion of

*that tax reduction would go into new investment and what proportion would go into the purchase of consumer goods?

Mr. HANES. No, Senator. I have no figure on that available. All I call ^{on} in answer to that is that I would suppose, and I would believe

it to be sound judgment, that this present tax bill as passed by the House should be somewhat reduced.

I think the present tax bill calls for a little more reduction in taxes than I think ought to be given at this time.

But the distribution of that reduction in taxes, as I pointed out in my statement, is not going to be any huge sum to anyone. The \$15,000-a-year man will get a reduction of about 45 to 48 percent in his tax bill.

Senator **BARKLEY.** To what extent, in your judgment, would the release of half of that sum, as a rough guess, in the purchase of consumer goods, affect prices.

Mr. HANES. I do not belong to the school, Senator, that thinks the taxpayer does not have brains enough to handle his own money.

Senator **BARKLEY.** I do not think that is involved here, Mr. Hanes.

Mr. HANES. I do think it is involved, because I say this: The average taxpayer today has no savings. He cannot save anything out of his income. It is just a physical impossibility, as you gentlemen here can testify yourselves.

I say the average taxpayer granted that relief is not going to go out and squander that relief on foolish things, nor go into the highly competitive market to run the price up on himself.

I think the wise fellow, who has the ability to earn \$15,000 a year, is going to put aside something for the rainy day, which he has not been able to do for the last 5 or 6 years.

Senator **BARKLEY.** Is it your judgment that the proportion of burden upon the lower income-tax brackets, which is way down below your \$15,000 a year, to use as an example, the 3, 4, and 5, and below 10, is proportionate?

Mr. HANES. Yes, sir.

Senator **BARKLEY.** I can remember the time when \$10,000 was looked upon as an enormous income, and now it is not quite that way.

But, taking the lower-income brackets and connecting that up with the cost of living, the difficulty of purchasing the necessities of life, do you think the lower-income brackets are bearing a disproportionate share of the total burden as compared to the higher brackets?

Mr. HANES. Senator **Barkley,** I do not think so, and I will tell you why I do not think so.

If you are going to raise anything like 37 to 40 billion dollars in taxes in this country, you have just got one place to go to get it, and there is no place else, and that is in the wage earners and the salary workers.

You cannot get it out of the high-income groups because it does not exist there.

If you tax the high-income groups to the ultimate limit, in my humble judgment, you could get a few, maybe \$800,000,000 more if you took it all away from them, but that is a pittance when you are talking about \$40,000,000,000.

But I say to you that wages and salaries of employees which amounted in the last year to approximately \$170,000,000,000 out of a total of \$196,000,000,000 is where you must go if you are going to raise the revenue you are trying to raise.

It is arithmetic. It is not philosophy. You cannot get it where it is not, and it is in the low-income groups.

Senator BARKLEY. Do you have any figures showing how much the total tax receipts were paid by people with an income of less than \$5,000 a year?

Mr. HANES. I have not those figures right here, but they are available in the Secretary of Treasury statement before the Ways and Means Committee. It is all very clearly set forth where that income is.

Senator BARKLEY. I will not take the time now. I thought you might have it in mind.

The CHAIRMAN. Senator Barkley, do you mind if I give you the rough division?

Senator BARKLEY. No; do not make it too rough, though.

The CHAIRMAN. The estimated tax liability under the present law for persons with net income before personal exemptions and credit for dependents of less than \$5,000 is \$11,965,000,000 out of a total of \$21,280,000,000.

In other words, \$11,000,000,000 for those under \$5,000 and the balance between 11 and 21 for those over 5.

Senator BARKLEY. You say before exemptions and allowances?

The CHAIRMAN. Yes.

Senator BARKLEY. Why before? Because what he pays is after that?

The CHAIRMAN. Let us take the figure after personal exemptions and credit for dependents. Tax liability under the present law is \$11,987,000,000 for those having income under \$4,000, out of a total of \$21,280,000,000 for those having under and over \$1,000 a year.

Senator BARKLEY. Would you mind preparing a blue print of that and filing with the hearings. You read the same figure there before and after, \$11,000,000,000. It cannot be quite that.

The CHAIRMAN. It does work out.

Senator BARKLEY. Maybe we can have it explained a little better when we get into that.

I did not want to go into it now.

I thought that possibly Mr. Hanes had it on his mind and it might be helpful, but we can get the exact figure before we get through the hearings.

The CHAIRMAN. I respectfully suggest it is reasonably clear that those under \$4,000 meeting your test after personal exemptions and credit for dependents paid \$11,000,000,000 plus. Those with \$4,000, and over \$9,000,000,000 plus, making a total of \$21,000,000,000.

Senator BARKLEY. What was the figure you first read there before making these exemptions and allowances?

The CHAIRMAN. The figure was \$11,965,000,000 for those under \$5,000. There is a slight change.

Senator BARKLEY. A change in the basis.

The CHAIRMAN. Yes, and \$9,000,000,000 plus for those over \$5,000 out of a total of \$21,000,000,000 plus.

What I first read was net income before personal exemptions and credit for dependents, and the base, changes there from \$5,000 to \$4,000.

Senator BARKLEY. That is all I want to ask.

Senator CONNALLY. May I ask a question, Mr. Chairman?

The CHAIRMAN. Certainly.

Senator **CONNALLY**. Mr. Lanes, a while ago, you cited this Gulf Oil Co. transaction.

I understood you to say the company offered the rights to purchase at about \$7 per share below the regular market. Is that correct?

Mr. **HANES**. No. I said the stock fell about \$7. It was offered below the market.

Senator **CONNALLY**. Exactly. That is what I am getting at. The Gulf Oil Co. valued its own securities, or property, at less than the market. There is nothing remarkable about the fact that other people in the market would naturally drop down to that figure, is there, in their purchases?

Mr. **HANES**. I think you have a misunderstanding there of just what happened.

I wish I could remember the figures, but let us assume the market was at \$70 a share, when they offered the stock at \$60. I think it was a little higher than \$70, but they offered it at \$60, we will say, or \$61.

The immediate effect of that offering was the stock dropped about \$7 a share on the floor of the exchange the first day.

Senator **CONNALLY**. That is what I mean. I suppose the buyer thought, "Well, if the Gulf Oil Co. does not think its stock is worth over \$60"

Mr. **HANES**. That is not the way it works, Senator.

Senator **CONNALLY**. I know it did work that way. You said it did.

Mr. **HANES**. We just do not understand each other.

Senator **CONNALLY**. You said immediately the stock was offered on the market, the market dropped, did you not?

Mr. **HANES**. I said exactly that.

Senator **CONNALLY**. If I were going to buy it, and the company itself said it was not worth but \$60, I would not want to give them \$70.

Mr. **HANES**. You have it your way, Senator.

Senator **CONNALLY**. That is very satisfactory.

Now Mr. Lanes, when a company, we will say, has a high profit and a high income but owes a lot of debts, do you believe that is a good time to pay some of those debts?

Mr. **HANES**. Yes, sir; I do, Senator. The same with the Government.

Senator **CONNALLY**. That is right. And when the country is prosperous and has a big income, can it not bear high rates of taxation better than in a period of depression and hardship?

Mr. **HANES**. Yes, Senator; that is obviously true, but I think—

Senator **CONNALLY**. Do not "but" too much, because you said it is obvious.

Mr. **HANES**. I want to qualify it with another statement, if you will permit.

Senator **CONNALLY**. Go ahead.

Mr. **HANES**. I want to say, in times like this, when we are having great business activity and prosperity, we should be preparing for the time when conditions are not going to be quite so good.

Senator **CONNALLY**. That is right. That is sound.

Mr. **HANES**. And I say this to you: You are not accumulating savings rapidly enough today to take care of the 600,000 or 700,000 people who are candidates for jobs each year.

If your present rate of employment of 60,000,000 people stayed exactly the same for the next 10 years, and there was no change in

that rate of employment, and we ran at this high rate of \$209,000,000,000 of income and \$240,000,000,000 of gross national product for the next 10 years you would have 7,000,000 unemployed. Do you understand that?

Senator **CONNALLY**. No.

Mr. **HANES**. Because our people are dying slower than they are being born, we have 700,000, approximately, becoming of working age each year.

Senator **CONNALLY**. They are going to eat more and wear more clothes.

Mr. **HANES**. Exactly, and they are going to have to have more tools to work with, and you are going to have to supply the equity capital for the tools. You are not going to put them to work if you do not supply the necessary capital.

Senator **CONNALLY**. You have made a pretty dark picture here about the conditions of the country and prospects.

Mr. **HANES**. No, sir.

Senator **CONNALLY**. And yet you say in a period of high prosperity. What is causing all this prosperity if you are correct about the dark picture?

Mr. **HANES**. The prosperity, obviously, is being caused by the high rate of production, the high rate of income enjoyed by our people, and the high rate of expenditure which is creating greater business for everybody.

Senator **CONNALLY**. That is right.

Senator **HAWKES**. May I interrupt there?

The **CHAIRMAN**. Are you finished?

Senator **CONNALLY**. Go ahead.

Senator **HAWKES**. I want to say to my friend from Texas, I think the high rate of business is caused by very substantial pent-up demand that came from 4 or 5 years of denial upon the part of the people of the things they wanted.

I think that is a very important factor, and it will not continue forever.

Senator **CONNALLY**. I do not think it is going to continue forever, and therefore I think when we are enjoying this degree of prosperity is a good time to pay some of this debt.

Our wise men who know about business—I do not, except that I pay my debts—you see all these dangers and "niggers in the wood pile," and fellows lurking behind the bushes who are going to assassinate us.

I think when we are enjoying prosperity is a pretty good time to pay some this debt and these taxes out of these large incomes which everybody admits.

Now you say they cannot get any venture capital. The companies are expanding all over the country right now.

Mr. **HANES**. Yes, sir. They have been expanding right rapidly.

Senator **CONNALLY**. Since the war.

Mr. **HANES**. Yes.

Senator **CONNALLY**. They are getting the capital from somewhere, are they not?

Mr. **HANES**. Yes, sir. Last year they got it out of retained earnings, not out of equities.

Senator **CONNALLY**. If they had their own money, why should they go out and highjack the public for some more?

Mr. HANES. I do not agree that they highjacked the public.

Senator CONNALLY. I do not mean to be offensive with that word, but I mean: You say they took it out of their savings. Why should they not? Where should they take it except out of savings?

Mr. HANES. That is a good place.

Senator CONNALLY. But you complained they should keep it and go out and sell new securities.

Mr. HANES. I said also they spent \$25,000,000,000 last year, of which \$15,000,000,000 only was out of their savings, which required the borrowing of money from other sources. They had to raise capital from other sources.

All I say to you is this: If you get your borrowed capital in industry in this country in a top-heavy position where your borrowed capital is greatly in excess of your equity capital, when you run into the slightest depression, that fixed charge is so great that it will cause bankruptcies. I submit it is what caused the bankruptcies in 1933 of so many of our railroads because of fixed charges on debt at that time.

Senator CONNALLY. That is all.

Senator BARKLEY. Let me ask right there: Did the expenditure of this \$15,000,000,000 out of income, or cash, of the \$25,000,000,000 you say was used for expansion reduce the rate of dividends to the stockholders on the whole?

Mr. HANES. Yes; I think it did. Last year all stockholders only received about \$6,800,000,000 in dividends.

Senator BARKLEY. Compared to what in 1946?

Mr. HANES. Well, the figure in 1946 was \$5,600,000,000.

Senator BARKLEY. So there was about a billion more paid in dividends in 1947 than in 1946?

Mr. HANES. That is right.

Senator BARKLEY. Notwithstanding they took \$15,000,000,000 out of earnings for expansion?

Mr. HANES. That is right.

Senator BARKLEY. And investment of that \$15,000,000,000 in expansion made the stock worth more than it would have been without it, is it not? As reflected in the value of the plant, and therefore the value of the stock?

Mr. HANES. That is true. The earnings should have been reflected in the value of the stock.

I do not think it was quite, because I think the stock market would tell you that a great many—

Senator BARKLEY. There are a lot of things that affect the stock market, and psychology is one of them, and jitters is another.

Mr. HANES. That is exactly right.

Senator BARKLEY. Let me ask you this: We owe about \$250,000,000,000, and you and I will not see it paid, and our children will not see it paid, and our grandchildren will not see it paid in all probability, and especially if something else happens that many people fear will happen in the world that will require a vast increase in our expenditures.

If there should be an upheaval that would bring about conflict among nations in the future and we had a \$250,000,000,000 indebtedness, what effect would that have upon the ability of the Government to borrow more money from the people to discharge the expenditures

that would be so essential in case we had to defend ourselves or preserve our institutions?

Mr. HANES. Senator, I think that is a very, very important question, and I am glad you asked it.

In the first place, if that \$250,000,000,000 remains static on our books and we get into a conflict, it would be a very serious matter in the financing of the conflict and the Government.

I do not think for a moment that the credit of the United States is in any jeopardy.

Senator BARKLEY. Not now.

Mr. HANES. Not now, and I do not think it would be then, provided that we take this economic system of ours and stop battering it around with socialistic enterprise, trying to mix the two together.

If you want a capitalistic system in this country, you have got to have a capitalistic system, and you have got to admit the inequities and inequalities that go along with that system.

With all its weaknesses, it is the best I know of in the world up to the moment.

Senator BARKLEY. I agree with you, but you keep referring to socialistic enterprises. What has the Government done and is the Government doing now that you so designate?

I realize you do not agree with a good many of us who have voted for and advocated legislation providing for old-age pension, social security—

Mr. HANES. Do not say I do not agree with that. You have not asked me.

Senator BARKLEY. I say we have done all that, and I would like for you to identify some of these things that you call socialistic enterprise we have got to stop.

Mr. HANES. Well, the attack upon the managerial class in this country is the first one.

If you will read Marx, you will find that is one of the first ways of going socialistic.

Senator BARKLEY. How are you going to prevent people from attacking something they do not like

Mr. HANES. I do not understand.

Senator BARKLEY. You mean the governmental attack on it, or individual attack?

Mr. HANES. Governmental attack on business.

Senator BARKLEY. How has that been done? Give me an instance.

Mr. HANES. I just gave you the instance—the increase in the income tax upon the individual to such a high rate that there is no savings left. That is an attack upon the whole economic system of the country.

Senator BARKLEY. I thought you meant by "attack," sort of an organized "denouncement," if I may use the word, of those who are enjoying these high brackets.

You are looking upon the high rates of taxes—

Mr. HANES. As an attack upon the economic system.

Senator BARKLEY. As a governmental attack upon big business?

Mr. HANES. I would not say big business, all business.

Senator BARKLEY. The bigger it is, the more you have got to shoot at, I suppose.

Do you mean by your reference to socialistic enterprises anything that Congress has enacted as a permanent policy of the country, such as those things I mentioned?

Mr. HANES. Yes, sir; I do.

Senator BARKLEY. Are you opposed to them?

Mr. HANES. All of the tendencies of the present day are toward subtracting from the earning capacity of industry. That is what I call an attack upon the economic system of the country, because you are killing the incentive of those who manage the enterprises.

You are killing the ability of those who have had savings in the past to reinvest those savings in industry, and that is killing our industrial system just as surely as we are sitting here today, and we are going to be reaping the fruits of that policy for the next 10 years.

Senator BARKLEY. Would you return to the status quo by repealing, for instance, the appropriations, and taking Government out of the business of helping to control floods, which Congress declared to be a national policy—rivers and harbors, improved highways, old-age pensions, unemployment compensation?

Mr. HANES. We are getting far afield. I would not do any of those things. I would curtail them.

Senator BARKLEY. According to your definition, they are an attack upon the economic system.

Mr. HANES. I do not think that has anything to do with the statement I made at all.

Senator BARKLEY. Then I do not quite comprehend your statement.

Mr. HANES. It is a very simple one.

Senator BARKLEY. All of these things are reflected in taxes and would have to be.

Mr. HANES. Of course. They could be placed on a self-supporting basis, Senator.

Senator BARKLEY. How would you do that?

Mr. HANES. The TVA, and all the other river authorities, the power developments, and so forth, they could be placed on more nearly an income basis than at the present time.

Senator BARKLEY. That may be. Flood control cannot be put on that basis.

Mr. HANES. No.

Senator BARKLEY. And rivers and harbors.

Mr. HANES. A good bit of that money could be saved, however.

Senator BARKLEY. Social security cannot be put on a self-sustaining basis.

Senator BREWSTER. I take exception to that. It can, and it should be.

Senator BARKLEY. What, social security?

Senator BREWSTER. Yes; I have told you that many times, but I will not belabor it now. You know my theory.

Senator BARKLEY. I know your theory and I do not agree with you.

Senator BREWSTER. I do not like to have you make such a positive statement. In your opinion, it cannot; and in my opinion it can.

Senator BARKLEY. I do not know how you would make it self-sustaining for an old-age pensioner who is indigent and according to our theory entitled to be paid an amount that would enable him to lead a decent life at a time he is no longer able to work, or is for other reasons unemployed.

If he could sustain himself, we would not have to be putting him Oil a pension.

Mr. HANES. I did not make any such statement.

Senator BARKLEY. I know you did not. You were interrupted.

Senator CONNALLY. Mr. Chairman, may I ask a question?

The CHAIRMAN. Yes.

Senator CONNALLY. Mr. Hanes, a minute ago you said there was an attack, as it were, upon the managerial class and that was interfering with our resuscitation and so on.

According to the figures you read a while ago, those under \$5,000, income were paying \$11,000,000, as against about 9 or 10 billion by those above \$5,000. Is that right?

Mr. HANES. As I understood the figures.

Senator CONNALLY. Would you regard that as an attack on the little fellow?

Mr. HANES. No.

Senator CONNALLY. If the tax above that is an attack on big fellows, why is not that an attack on the little fellows?

Mr. HANES. I think, at the present time, Senator, everybody in the country is suffering from a drastically high income tax.

Senator CONNALLY. I thoroughly agree on that, and if we ever are to pay this debt, they are going to have to suffer drastically for a long time.

Mr. HANES. Perhaps.

Senator CONNALLY. No perhaps about it. It is a cinch.

Mr. HANES. They need not suffer quite so badly as they are suffering at the present time because our surpluses prove that.

Senator CONNALLY. That is all.

The CHAIRMAN. Senator Lucas?

Senator LUCAS. Mr. Hanes, you have been talking here about savings and contending there is no opportunity at the present time for saving under the present tax system.

Mr. HANES. Yes, sir; may I just correct that?

Savings of tile type that would be invested in equity capital.

Senator LUCAS. In your statement, on page 6, you say:

In the same period, while individuals were cutting down their corporate security holdings, liquid savings increased in the astronomical amount of \$182,000,000,000.

What is the source of that?

Mr. HANES. The source of that is the Securities and Exchange Commission.

Senator LUCAS. Who gets the \$182,000,000,000 that went into savings during this period?

Mr. HANES. That went to all the people in the United States, all the workers.

Senator LUCAS. Management got a little of that, did they not?

Mr. HANES. Management and corporations. We know exactly what corporations got.

Senator LUCAS. Is it not an astounding fact that in this time we could save \$182,000,000,000?

Mr. HANES. That is right, but that savings, Senator, as I pointed out in the Securities and Exchange analysis of that savings, was going largely into sterile types of securities. In other words, they were not going into equities. They were not building for the future.

Senator **LUCAS**. How would you control that? How would you keep them from going into the sterile securities?

Mr. HANES. There is no way I would suggest that you should keep all of them out of sterile savings. There is a group of people above a certain level who formerly had savings. This is all that I am referring to. Those people at the present time have no savings.

Those savings were available for equity investment for common stocks, if you will. And I say the evidence points to the fact that those savings have been eliminated because we are not getting the proper amount in investment in enterprise through the equity side that we require to keep people working.

Senator **LUCAS**. You may be correct, but it is rather difficult for me to understand how in this period of time, 1910-17, that we could save \$182,000,000,000 if the corporations, this group you are talking about, in the high brackets, so-called, would not at least get a fair share of that \$182,000,000,000.

Mr. HANES. They have gotten it, Senator, but they have gotten it through ways increasingly dangerous to the economy, because they have gotten it through borrowed money. That is the point I am trying to make.

Senator **LUCAS**. During the last year, the corporations made \$19,000,000,000 in .

Mr. HANES. I think it is \$17,000,000,000 after taxes.

Senator **LUCAS**. \$17,000,000,000 after taxes?

Mr. HANES. Yes, sir.

Senator **LUCAS**. They paid out to the stockholders, in dividends, about \$5,500,000,000.

Mr. HANES. \$100,000,000,000.

Senator **LUCAS**. All right; \$6,800,000,000. That left some \$11,000,000,000 or \$10,000,000,000.

Mr. HANES. \$10,000,000,000.

Senator **LUCAS**. For investment purpose.

Do you know of any other period in the history of this country where the corporations had \$10,000,000,000 in any one year on profits that they made for investment purposes?

Mr. HANES. No; I think that is the highest period of our history.

Senator **LUCAS**. As a layman, it is a little difficult for me to understand, when we get those figures before us, just how these corporations are suffering. I do not quite follow it from the standpoint of investment, the standpoint of expansion, when you have the largest amount of money in the history of the corporate period for that very purpose.

Mr. HANES. Senator, let me go back a little bit in the history of this thing.

Senator **LUCAS**. I wish you would.

Mr. HANES. After V-J-day, after the war, one of the first acts of the Congress was the repeal of the excess-profits taxes. It did repeal the excess-profits taxes.

You did reduce the taxes on corporations by about 2 percent in addition thereto. You did reduce the taxes on individuals by about 5 percent.

That created a feeling in the minds of people—the business people—in this country—and I submit this is a very important point and one which we should not ever lose sight of—that created a feeling in the

minds of **the** business people in this **country**—an atmosphere or a climate, if **you will**—of a belief on the part of the managerial people of **the country**—**the** people managing our **industries**—**that** our Government was not going to use this instrument of the excess-profits tax except in the most drastic emergency of war.

It created an atmosphere which encouraged business to go out and borrow money, or raise money from equity securities, or in any way they **possibly** could in order to expand their production and business.

I believe you will find we have expanded production **by** about 52 percent since **1945**.

Senator **LUCAS**, **I** agree with you it does have a **psychological** effect on business that is good, but there is not anything **in** this picture that **I** can see which has deterred business from **further** expansion as the result of tremendous profits they have made and put back into expansion.

It may be, as Senator Hawkes said, it cannot go on forever. Maybe you are correct. But it is a little confusing for me to follow through on your **theory** in view of the facts before us.

Mr. **HANES**, Maybe it would clarify it a little bit, as **I** pointed out a moment ago, if you say it is dangerous, to get the country all on a debt level. **We** should have some base.

Our system—our economic system—is built up largely of three types of securities: (1) The common stock which is at the base of the pyramid; (2) the preferred stock which follows on top of the common; (3) the borrowed capital or bonds.

That is our customary way of financing.

Last year the figures given **by** the Secretary of Commerce, which are attached in the New York **Times** editorial to my statement, were to the effect that industry spent about \$25,000,000,000 **in** the expansion program after the war **in** reconverting itself to peacetime pursuits to take care of the pent-up demand and the large demand which had not been supplied during the war.

Of that amount they saved out of their earnings about **\$10,000,000,000**, as you pointed out a moment ago.

In addition thereto, they got another \$4,500,000,000, roughly, just under **\$5,000,000,000**. They got that **\$5,000,000,000** from depreciation **and** that was spendable income, which raised the total they **saved** through their own efforts of **\$15,000,000,000**.

Now, the balance of that money had to **be** raised from some other **source**, and all I am trying to drive home is the balance of **\$10,000,000,000** **has** got to be raised from somewhere.

I submit that it is much more healthy for that **\$10,000,000,000** to be raised through the medium of common stock, or in large measure common stock, rather than borrowed capital.

Senator **LUCAS**, How is this tax bill going to affect what you are talking about?

Mr. **HANES**, The only way in the world it can affect it, and I very much hope it will do so, is to create savings again for that group that formerly invested in equity securities.

Senator **LUCAS**, Would it have **only** a **psychological** effect upon **them**?

Mr. **HANES**, **No**, sir; **I** think a real effect. It would depend upon the amount of savings **the taxpayer** made under the tax system.

Senator **LUCAS**. Take your Gulf Oil Corp. How will this tax bill affect the Gulf Oil Co.?

Mr. **HANES**. It will not affect it at all unless it creates a certain confidence that the Government has got the interests of industry at heart and wants industry to expand and wants its citizens to have savings to buy common shares.

Senator **LUCAS**. You are going a long way on climate and atmosphere.

Mr. **HANES**. I do not think I am going far enough.

Senator **LUCAS**. Maybe not.

Mr. **HANES**. I think it is one of the most important elements in the whole economy.

Senator **LUCAS**. But the only real incentive from the standpoint of finance that a corporation would get for the purpose of investment would be to reduce the corporate tax, would it not? I am talking about straight money now.

Mr. **HANES**. Not the only way. It would be a helpful way.

If the corporation got more income in spite of the fact the tax remained constant, its savings would be greater, assuming it paid a constant amount in dividends.

Senator **LUCAS**. I was interested in the Gulf Oil and this other concern in Pennsylvania that Senator **Martin** mentioned, because I was under the impression this is going to take care of these two concerns up in Pennsylvania that are now having a difficult time trying to sell some stock.

I guess I am wrong.

Mr. **HANES**. You do not think that, do you?

Senator **LUCAS**. I certainly do not, and you do not, either. There are the two examples given here before this committee as a basis as to why we should have this tax bill.

Mr. **HANES**. No; I do not think that is quite accurate.

Senator **LUCAS**. Why are you placing them before the committee, then?

Mr. **HANES**. Those two examples were given merely to show the fact, as I understood the Senator to say, and my addition to it, that there is no desire on the part of the investor to buy equity capital, or he has no savings with which to do it.

Senator **LUCAS**. He will not have after this bill is passed, either, to do the things Gulf Oil, or any other concern wants to do. It will take more than this little tax bill of \$4,500,000,000 to take care of a concern of that kind.

I submit that with all sincerity.

Mr. **HANES**. I think that is a proper statement and I think this is a faltering step in the right direction.

Senator **LUCAS**. You may be right on that.

I just want to turn to the table that was submitted before the House of Representatives which shows the 71.62 percent of that \$6,500,000,000 will go to those receiving an annual income of \$5,000 or less; and from \$5,000 to \$10,000, 6.02 percent; \$10,000 to \$15,000, 8.82 percent; \$25,000 to \$50,000, 6.09 percent; \$50,000 to \$100,000, 3.61 percent; \$100,000 to \$300,000, 2.05 percent; \$500,000 to \$1,000,000, 0.27 percent; and \$1,000,000 and over, 0.20 percent.

I mention these figures in the belief that there is very little in the group over \$5,000 which is real incentive from the standpoint of risk.

Mr. HANES. That, Senator, I cannot argue with at all, because, as I said, it does not go as far as it ought to go in my humble judgment.

You should put the uppermost limit on the take that you subtract from any individual's income at something not over 50 percent.

Senator LUCAS. Last year you were very much opposed to the exemption of \$500 to \$600?

Mr. HANES. That is right. I testified I did not like that at all, and I still do not agree with it.

Senator LUCAS. You still do not agree with it, but in order to get a tax bill, you would be willing to let that go in?

Mr. HANES. That is exactly the only reason I would agree to it, that we can pass it over a veto, perhaps, that way.

Senator LUCAS. The Knutson bill, on a yearly basis, as I understand it, would cost \$6,500,000,000 for the fiscal year 1949. The bill would cost \$7,100,000,000 if it were made retroactive to January 1, 1948. Which do you favor?

Mr. HANES. Perhaps you were not here when I said to Senator Barkley—

Senator LUCAS. Which do you favor? I am talking about the date now.

Mr. HANES. The date I favor is January 1, 1948.

Senator LUCAS. January 1, 1948?

Mr. HANES. Yes, sir.

Senator LUCAS. That would cost the Treasury about \$7,100,000,000 if made retroactive to that date.

As I understood you to say to Senator Barkley, you thought that might be a little too high. Is that right?

Mr. HANES. That is right.

Senator LUCAS. Why do you say that?

Mr. HANES. I am just relating that to what I believe the budget figures are going to show.

Senator LUCAS. You figure it is a better opportunity to pass a bill around \$4,000,000,000 than \$6,500,000,000; is not that the real reason?

Mr. HANES. That is the practical side of it. I also think it is probably a better fiscal policy for us to pursue to go a little bit slowly and feel our way along in this situation.

I do not want this to happen, that we cut too deeply into the tax take of the Treasury, so that we might not reduce what looks like a large surplus to a deficit. I think it is a prudent way to approach it.

Senator LUCAS. I understood from your statement you figured there would be about \$10,000,000,000 surplus in this fiscal year 1949. Is that your statement, or am I wrong?

Mr. HANES. I think that is the correct figure; yes, sir.

Senator LUCAS. \$10,000,000,000?

Mr. HANES. Yes, sir.

Senator LUCAS. What would you say about a tax theory of applying one-half of any surplus we have to the national debt and the remaining one-half in reduction of taxes?

Under your theory, you have got \$10,000,000,000.

Mr. HANES. Yes; \$10,000,000,000.

I tell you I do not like arbitrary figures.

In the first place, I think you have got to adjust your way of going to the national economy, and it may be at some time in the nearby

future you will want to change from the deflationary effect of retiring Government debt too rapidly.

Senator LUCAS. That would not be difficult to do.

Mr. HANES. No.

Therefore, I say it is a mistake to adopt an arbitrary percentage because we cannot foretell the future. We do not know what is going to happen 6 or 10 months from now.

Senator LUCAS. Your tax bill would be just for 1 year.

Mr. HANES. This tax bill would not, I hope.

Senator LUCAS. But you would not want to speak out for a theory that would definitely, every year, apply something on the national debt, even though we had only a billion in surplus—give \$500,000,000 to the taxpayers and \$500,000,000 to the debt?

Mr. HANES. No; I would not go for that, Senator, at all.

I think if you had an ideal situation where you could adjust your way of going more quickly than we can under our present system, it might be.

Senator LUCAS. If the people of America knew that every year we had a surplus there was going to be something applied on that national debt, would not that be these fellows you are talking about now, who are a little afraid of what the future is going to be?

Mr. HANES. Yes, sir; and I will give you a concrete method of how that can be done and right now.

Senator LUCAS. This is just a brainstorm of mine and may not be any good.

Mr. HANES. I think you are absolutely right.

I submit, and I have said on many occasions, you have got an ideal vehicle of constant reduction which everybody in the United States would understand if you were to adopt it, and that is to take every dollar paid into the Federal Treasury for social security or old-age benefit taxes and apply it immediately upon the Federal debt. That would reduce your debt at the rate of \$2,000,000,000 a year approximately. In 100 years the debt would almost be laid off.

Senator CONNALLY. May I ask you in that connection: That money collected is not collected for the purpose of carrying on the current expenses of the Government.

Mr. HANES. It is spent for that purpose, however.

Senator CONNALLY. But it is borrowed under the law from the fund. So it is part of the public debt, and it would be like a seesaw. You would increase your public debt to the security fund and pay off that much in the regular debt.

Mr. HANES. I maintain that is not income of the Federal Government.

Senator BARKLEY. I have, too, and gotten into a very famous controversy over it.

Mr. HANES. I remember it. I read what you said about it at the time, and I agreed with you.

I think that part of our financing is wrong.

Senator BARKLEY. Congress intended that as a method of investing these funds at 3 percent interest so they would earn some money.

Mr. HANES. That is right.

Senator BARKLEY. And if the Congress felt it was a safe investment, a safer investment to have these funds in the Treasury invested

in securities of the Government than it would be to go out and buy private securities, I think that is sound.

Mr. HANES. So do I, but the Federal Treasury has taken those payroll taxes as current income.

Senator BARKLEY. No; they have borrowed from the fund and used it as current expenses, but they still owe it back to the fund.

Mr. HANES. There is no difference which way you put it. They spent the money and I maintain it was a sacred trust paid in to this Government for benefit to be derived by the donor at a future date, and it should be like a reserve fund of an insurance company, and should be maintained inviolate.

Senator CONNALLY. Maybe it was a mistake of the Congress in making it necessary for the Treasury to invest in Government securities.

Mr. HANES. No, sir; I do not think so. I think it is an admirable manner of retiring the debt.

Senator BREWSTER. May I ask a question, there?

Senator LUCAS. I would like to ask one more question. I was the last one called by the chairman.

The CHAIRMAN. Go ahead.

Senator LUCAS. Senator Barkley questioned you about it, and I think we ought to look at it again.

You say our obligations are so great we cannot afford any further experiment in socialization.

I wish you would break down for the record to tell this committee what these experiments are in socialism.

Mr. HANES. May I supply that?

I will give you chapter and verse and start back in 1933.

Senator LUCAS. You give us one chapter.

Mr. HANES. May I supply it for the record so it will be accurate? experiments.

Senator LUCAS. You supply it for the record and give us these pertinent Now you are talking about Government and talking about tax legislation here today, and these experiments must necessarily refer to what Government has done in the way of legislation.

Mr. HANES. That is right.

Senator LUCAS. And you name those, because I want to see what my good Republican friends will do toward repealing those things you are going to name.

Mr. HANES. It does not necessarily follow, Senator, that all should be repealed.

Some should be modified, perhaps, but it does not follow they should be repealed, and I am the last one to advocate that.

But I would like very much to do just as you say and give you a complete break-down.

Senator LUCAS. I wish you would, instead of that broad statement you made to this committee.

I would like to have you place in the record your statement on these socialistic experiments.

Mr. HANES. I would be delighted.

(The report referred to will be found on p. 597.)

Senator BARKLEY. Would you mind going back a little further than 1933 and indicating whether you think the creation of the Reconstruction Finance Corporation was a socialistic enterprise?

Mr. HANES. I will go back to 1930, if you like.

The CHAIRMAN. Senator Hawkes?

Senator HAWKES. May I make a brief remark in there?

When you talk about repealing all these things, I notice the human family accumulates a lot of bad habits during the year, and they make New Year's resolutions, but they do not repeal very much. When they have accumulated the habits, and they have become fixed, you may improve yourself but you cannot repeal anything.

Senator LUCAS. You are making an argument it is whose fault?

Senator HAWKES. I am making an argument things wished on the people and in existence for 16 years are very hard to shake off, whether bad or good.

Senator BREWSTER. Before Senator Barkley leaves, I would like to point out that in the RFC, we wrote off some \$2,000,000,000 to \$3,000,000,000 in the socialistic enterprises in which they had engaged. That item was shipped down when we were unaccounted with other things and has largely been forgotten in the very creditable work RFC otherwise has done.

Are you familiar with that record?

Mr. HANES. Yes.

Senator BREWSTER. When Mr. Jones sent up the request to write off some \$2,000,000,000, \$100,000,000 went up to the State of Maine from which we have never been able to get accounting from either Mr. Jones or Mr. Hopkins, or anybody else concerned.

Senator BREWSTER. I did want to also query your social security theories.

Senator BARKLEY. I am not on the witness stand. I will go on, if you want me to.

Senator BREWSTER. It was obvious you were in need of education.

Senator BARKLEY. When I am seriously in need of education, I will go elsewhere to get it.

Senator BREWSTER. I am very much interested in this comment on the social security situation in which Senator Barkley used the figure of \$2,000,000,000 being paid in there by the people for social security, which was going into Government bonds and then being spent currently.

I am not sure as to the total, but taking that as the figure which is paid let us say for the old-age insurance over a period of a considerable number of years, is ultimately under the theory paid back to the individuals who have contributed. Let us take a small man up in the State of Maine who has been paying 20 or 30 or 40 years into this.

You are old enough, I believe, to remember the value of a dollar in 1906-13, when we were getting very modest wages and living very modestly, and were able to get along.

Now arriving at old age, we collect \$30 which might have been considered adequate in those days and even up to more recent times, \$60 or \$75 a month would be essential to supply the same means. In other words, we are at the bare margin of existence on the \$30 a month in other days and we are way below the margin of existence now.

On what basis do you, if you are an advocate of this social-security system, or others who have advocated it in recent years, justify paying back to the people 50 percent of the purchasing power of what they have paid in, which is the result of the system as it now operates?

Mr. HANES. Senator, I think that is all part and parcel of the thought I had in mind when I suggested that it is completely wrong in my humble judgment that we take this \$2,000,000,000, or roughly \$1,800,000,000 to \$2,000,000,000, of the people's money which we promise to pay back at some future date and put it right away into the bloodstream of the circulation system and spend the money. When those benefits start to flow back the other way, you are going to have to tax the people over again for the same money to pay off these promises.

Senator BREWSTER. You compound the felony on your theory

Mr. HANES. I think it is a felony.

Senator BREWSTER. Because you not only return the fellow a 50-cent dollar, which is what he gets approximately today, or less than that now compared with 1913—

Mr. HANES. I think it is less than that.

Senator HAWKES. About 48 cents.

Senator BREWSTER. Under 50-cent dollar. You not only give this poor fellow who has labored all his life under assurance by the Government of being taken care of in his old age, in a 50-cent dollar, but in addition levy a tax, some portion of which, through various excise taxes, he has to pay.

So he not only gets half, but, in addition, has to contribute very substantially in order to pay himself back.

Mr. HANES. Senator that is true.

But I will say, in absolute fairness to the present situation, that same thing is true of all Government securities and of all business securities which are on a fixed interest-bearing basis.

Senator BREWSTER. The only difference is in all those other securities the individual has an election. Here this is a compulsory system we are imposing.

Mr. HANES. That is a difference.

Senator BREWSTER. The Government here goes to a man and says, "We will do this, and we will ultimately do that for you."

And the time comes around and he finds it is a bunco game.

We had this matter up some time ago. As we were going on with the veteran system, we adopted a system of giving every veteran of the Spanish War a stipulated amount, I think \$75, irrespective of any dependents.

We have about 18 million veterans of this present war who will ultimately unquestionably be entitled to the same relief.

How soon are we going to recognize that old age should be provided for on a current basis and levy of an annual tax which will respond to current purchasing power and eliminate the growing and grotesque injustice that the present system perpetuates?

Mr. HANES. It is a very serious problem.

Senator BREWSTER. Would you not agree it would be much wiser to tax all of the people each year and pay all of the old-age pensioners each year in order to reflect the current value of the dollar, and everyone contribute when they are able and receive when they are in need?

Would it not be a much wiser, much fairer, and much more equitable solution?

Mr. HANES. Yes. I would hate to see it imposed upon the people right now.

Senator BREWSTER. I recognize the problem, but I am looking at the long range.

Let us look ahead **30** years and see where we **are**. Let us see what we have done by **the** whole social security system, by **the** bunco game **we** have perpetrated on the poor people of this country in the last **10** or **1** years, and then see if we cannot look forward to an adjustment which will insure greater **social** justice.

The CHAIRMAN. Senator **Hawkes**?

Senator **HAWKES.** Mr. Chairman, it is amazing to me **the** stupidity that is invoked in considering this whole **subject**. There are **irrefutable** facts.

I want to ask Mr. Hanes: **How** are you going to **pay** this national debt everybody is so anxious to pay if you **do** not keep **the** American system and **keep** **the** initiative **alive**?

Mr. **HANES.** That is right.

Senator **HAWKES.** These people **do** not know what they are talking about. It is the most absurd thing I have ever heard in my life.

Men from all over the country are **coming** to my office and going into everybody else's office and saying: "**Why** should I make **\$100,000** only to **keep** **\$20,000**?"

That is what they are saying.

I want to say this: **Why** has the world been to our doorstep twice to have us save them **Because** of this putrid **system** of ours? **Because** of this system of ours that created reward to stimulate initiative and enable genius to come into **play**?

What are **the** American people thinking about? The whole world has been hanging around here. They think every day in the year is **Christmas; Santa Claus** 365 days a year.

Here we are talking about not being able to reduce taxes to stimulate initiative and keep it alive and **keep** the American system alive, and **yet, on** the other hand, we are talking about giving **\$21,000,000,000** more to nobody knows what and whom.

It is the most amazing thing.

The propaganda machine that has been built up, the propaganda machine that has been built up to foist this thing on the unsuspecting people, is **the** most terrible thing that has ever been **done** in **America**.

You go and ask **the** taxicab driver. Go ask my **chauffeur**. Go and ask **the** workingman in my plant whether they want to give away **\$21,000,000,000** more.

They are willing to **feed** starving people, but they **do** not want to become involved and entangled all over the world as we are becoming.

It is diametrically opposed to George **Washington's** Farewell Address, which people **now** **do** not listen to and laugh at when it is read.

I am saying to you **the** American people have got something to think about.

I want to say this, **Mr.** Chairman: Since I have been in this room, nobody has said anything about what kind of a dollar this is **the** corporation is getting.

The CHAIRMAN. Mr. Hanes did.

Senator **HAWKES.** Maybe **he** did while I was out, but unless we realize this dollar **the** corporation is getting, and these profits everybody is sneering at, unless we realize it is a 48-cent dollar and that the same kind of a dollar that made it necessary to raise the wages of the workingman from **100** to **130** or 140 percent; the same kind of a

dollar that put roast beef up from 35 cents a pound to \$1.25, the same kind of a dollar that made clothes almost double in value; unless we are sane and realistic and practical, this country is absolutely doomed to socialism.

As long as we keep unemployment compensation administered the way it has been administered, not to help people who are neatly but to help people when they do not want to take anything except an tailor-made job—I drive down here every day past the unemployment office, and when the world needs workers, see a line two blocks long, and yet I am begging for somebody to do something for me.

As long as that false administrative system is followed in the administration of unemployment insurance you have got no hope in the world.

I just cannot understand why the people have forgotten their things that made America.

I want to say to you if these gentlemen in the Senate do not realize that initiative in America is hanging by its eyelids right now, and the only difference in this world between the United States of America today and the nations, socialistic and communistic, now on the junk pile, is the fact we have had a government that, under the Constitution of the United States, recognized property rights. We have had a Chief Justice John Marshall who admonished us once that "the power to tax is the power to destroy," and that is what they are doing.

And if we kill initiative, we are as through as we can be as a great free-enterprise nation and a nation of freemen.

I want to say that, and I thank the chairman for letting me say it. I had it in my system and had to get it out.

THE CHAIRMAN. I am glad you got it out.

Mr. HANES with reference to the suggestion that we have a rigid method of debt retirement, you will recall the administration last year said it proposed and thought it a sound policy to use all of the surplus for debt retirement?

MR. HANES. Yes.

THE CHAIRMAN. You have also observed reports of press conferences with the Secretary of the Treasury to the effect that much greater care must be taken in the reduction of debt due to its obvious credit-contraction possibilities, and therefore you cannot say we are going to put all of our surplus, or any set percentage of our surplus, to retirement of debt because you cannot anticipate in advance what the credit situation will be and therefore you have got to preserve flexibility.

MR. HANES. That is right.

THE CHAIRMAN. Right now, I think the consensus of opinion of students of the subject is that to apply the whole surplus to fiscal 1948 would be a catastrophic thing to do.

At the present time the bankers all over the country are very, very nervous about credit contraction. They are calling in their debtors and making the debtors nervous, and think the circumstances are very obvious which require that we should be very careful about profligate, untimely, excessive debt reduction in critical periods like the present.

Your point, as I take it, was that the savings of the country are not going into risk investment; on the contrary, they are going into indebtedness investment?

MR. HANES. That is right.

The CHAIRMAN. I would like to put in the record an excerpt which supports you, from the Survey of Current Business of the Department of Commerce of February 1948:

A notable feature of the 1947 market for new issues was the pronounced rise in importance of debt as opposed to equity issues. Volume of new stock issues was about the same as in 1940, whereas fixed interest-bearing issues expanded by about 50 percent. In 1940 over two-fifths of the new capital issues were stocks. In 1947 the proportion dropped to less than 30 percent.

The proportion of debt issues to the total was roughly equivalent to that which prevailed in past prosperous years, including 1929. A substantial fraction of the total debt in 1947, however, was convertible debentures which represents call upon common stock at a fixed price.

The supply of savings made available for the purchase of corporate security issues was channeled to a considerable extent through life-insurance companies.

In other words, tile savings of the people tire not entirely idle, but, and interpret what you said and what has been read here, they do not feel they are adequately compensated because of tile income-tax structure in taking risks, and therefore they channel their savings into the utility companies and telephone companies and into bond issues and into preferred securities. Is that correct?

Mr. HANES. That is exactly right; yes, sir.

The CHAIRMAN. We were talking about the take-home pay of the investor and comparing what a man must have today to equi his income of 1939.

If you will be patient for just a moment, I would like to give something in the record.

In order to have tile same income left, after taxes, under present tax rate as we had in 1939, an individual with net income of \$5,000 a year in 1939 must have a net income of \$5,684 today.

It takes a net income of \$9,550 to give the same income, after taxes, as was enjoyed by a taxpayer with \$8,000 net income in 1939; \$12,257 income today to match a \$10,000 income of 1939; a \$20,119 income to equal a \$15,000 income of 1939.

To match a \$25,000 income of 1939 it is actually necessary to have an income of over \$40,000.

That with the figure we were talking about, and earlier today I thought it was somewhat higher than it is.

A \$50,000 income in 1939 represents the equivalent of an income of nearly \$124,000 today.

As you can see, the higher up tile income scale, tile more fantastic is the increase in income which is necessary to have today to match an equivalent income after taxes in 1939.

Senator HAWKES. Alight I interrupt, and ask you if I am not correct in that you tire talking simply about Federal income?

The CHAIRMAN. That is all I am talking about.

Senator HAWKES. When you add the State income taxes, that reduces the retaining amount, and that is tile thing that is vital.

The CHAIRMAN. That is correct.

Senator MARTIN. Might I make a further observation and that is you are not taking into consideration tile smaller buying value of the dollar at the present time.

The CHAIRMAN. I was coming to that.

A \$228,000 income now is equal to only an income of \$75,000 in 1939. An income of nearly \$313,000 represents the equivalent of only \$100,000 income in 1939.

An income of over \$1,260,000 would be required today to give the same income after taxes as a \$500,000 income in 1939.

That will show the effect of these steeply progressive rates which already existed in the late thirties, but which has been enhanced by the taxes that were necessarily raised during the war.

As Senator Martin points out, that takes no account of the difference of the purchasing value of the dollar.

Did I understand that in a discussion with one of the Senators, you took the position that the Federal Government has no right to tax people merely because it believes that it can spend the money better than the citizens?

Mr. HANES. Yes, sir; that is my opinion.

The CHAIRMAN. Do I understand you are in agreement also that until we can get this world set for peace and get rid of these extraordinary military expenditures and foreign-affair expenditures that we cannot expect the truly massive reduction in taxes that we all, I think, or most of us, would like to see?

Mr. HANES. That is right, under the present conditions.

The CHAIRMAN. But I understand your theory is also that when we can we should make a start at it, and should keep on working at it as long as we can.

Mr. HANES. That is right.

The CHAIRMAN. In preparing your supporting data on the nature of the rate structure, you may find plenty of documentary material in the late thirties which would demonstrate, I believe, conclusively, that the progressive rates which were then adopted were intended to be punitive and were intended to equalize wealth.

Mr. HANES. Yes, sir; I do not think there is any doubt about that.

The CHAIRMAN. Any further questions?

Senator MARTIN. I would like just one.

My recollection is, Mr. Hanes, you stated there would be annually 60,000 men seeking new jobs because of increase in population?

Mr. HANES. Each year; yes, sir.

Senator MARTIN. What is the present estimate of the investment required for tools for those men?

Mr. HANES. There was an interesting statement made time other day by the International Harvester Co., who have just increased their employment 30,000, and I think they showed it required about \$6,000 per man to put those men to work.

The average of all industry runs between four and nine thousand dollars to put one man to work. That is tools, equipment, housing, building, hospitals, machinery, everything.

In 1938 I testified before the House Ways and Means Committee and in that testimony I made the same statement practically that made here today on this subject.

I would like to read for the record just for a moment one statement I made which will show you, in answer to your question about what it was then.

Translating that into the present-day dollar will make a difference, of course.

For the record, what I quote is Revenue Revision of 1939, hearings before the Ways and Means Committee of the House of Representatives. I was appearing there as a witness, being Under Secretary of the Treasury at that time.

Isay here:

Under our system of economic development of this country—

This was in answer, by the way, to a question from Mr. Treadway, who was ranking minority member at that time.

Under our system of economic development in this country, it requires about \$7,000 per man to put one man to work and to keep him there. That is in tools and machinery and equipment, and so forth. That alone would make necessary the investment in our economic system each year of 7,000 times approximately 600,000 new people who are candidates for jobs each year, while means an approximate investment annually of \$4,200,000,000, just to take care of the normal increase in our employable population.

That was in the 1939 tax bill.

It does not think there has been any decrease in the rate of growth of our population, which would lead me to believe, the population having expanded to about 144,000,000 people, the rate would have gone up from 600,000 people annually in candidates for jobs to 700,000 annually.

So that means we have to reinvest into our economic system each year an investment equivalent to 700,000 times 7,000, or \$4,900,000,000.

Senator MARIN. If we are not in a position to do that, then the American system of free enterprise fails to that extent?

Mr. HANES. If you wanted to devise a method of keeping the American system from working, it would be to stop the investment of \$4,900,000,000 annually, and you would have an army of 7,000,000 unemployed even if the high rate of employment today continued for 10 years.

Senator BREWSTER. When you speak of employables, does that include agricultural and domestic labor?

Mr. HANES. Just the industrial workers.

Senator BREWSTER. When we speak of this figure of 60,000,000 jobs; what is that?

Mr. HANES. That is for everybody. That includes, as I understand it, all the employables in industry and self-employed as well.

Senator HAWKES. Mr. Chairman, I want to ask one more question.

The CHAIRMAN. Go ahead.

Senator HAWKES. It is as certain in my mind as anything could be.

Let us go back to the point I raised a few minutes ago. If you are going to pay this debt of \$255,000,000,000, knocking off \$5,000,000,000 for luck and calling it \$250,000,000,000, there is only one way in the world to do it, and I want to see if you agree with me. That is, to keep alive the spirit of initiative through some reward; that is, retainable. It does not make any difference what you earn, it is what you retain.

Do you agree?

Mr. HANES. Heartily agree; yes, sir.

Senator HAWKES. Then do you agree the only sane way for our people to do is to not pay so much off on the debt any one year that they are destroying this mainspring of initiative that keeps the machine going, that produces the fruit and profits, the money the tax money is taken from, with which the debt is paid?

Mr. HANES. I agree with you.

Senator HAWKES. If we do anything other than that, we are breaking faith with every person who invested their money in Government bonds. Do you agree with me?

Mr. HANES. I would qualify that somewhat, **Senator**, by stating that would depend a little bit upon whether you are going to return a dollar or 40 cents.

Senator **HAWKES.** You are going to return 40 cents. I will give you a written guarantee on that, or 48 cents, whatever it is.

I have **one** abroad many times. I can recall when **the** franc was selling at 23 cents almost equal to one of our quarters. It is now selling for 225 or 250 to a **dollar—less** than one-half cent.

Every nation, Mr. Hanes, abroad that has gone to the junk pile has devalued its money **and** devalued its money until it **is** nothing today.

That is the process we are in. If we have not got intelligence enough to find a way to stop that, **we** are doomed.

The only way in the world you can stop it, if I know anything about business or about **America**, **is** not to crush this **spirit** of initiative.

There **are** some men in the Senate who do not know **what** the spirit of initiative is.

We had one Senator **get** up on **the** floor and say **he** was **not** interested in any way in free enterprise; that he did not care whether we preserved **it** or **not**.

He was interested in human rights. He **did** not understand the greatest human right **on** this **earth** **is** the right to own property and **be** a free man, and **to** improve your lot.

He had not been all over Africa and all over the world and seen where that right did not exist—the people were virtually slaves.

I want to **find** out if you agree with me there is nothing in this world so important as not to crush this spirit of initiative, and that we should not **be** involved in making a great payment on the debt at the expense of keeping the machine going.

Mr. **HANES.** I would certainly agree that the climate you have created here in Washington has got more to do with **the** speed with which the economic machine runs than any other one thing I know of.

Senator **BREWSTER.** **Is** it not rather refreshing to you to find this accent **on** budget balancing and debt retirement after your experiences of **some** 10 years ago?

Mr. **HANES.** I would say it is a very different state of mind.

Senator **BREWSTER.** In certain quarters.

Senator **HAWKES.** Mr. Hanes, I would like to just put on the record an illustration I know from American life.

A **concern** had two good years and made a lot of **money**. It had **a** lot of bonds they did not have to pay.

They got this insane idea that they should pay off all debts **and** they paid them **all** off, and then the depression came along and business was **very**, very bad.

They tried to borrow money to **run** the business under **these** conditions, and **to** do it they **had** to issue **mortgage** bonds and at a rate of interest that crushed them and destroyed them, and they went into insolvency **and** were disintegrated **and** **bought** up for 10 cents on the dollar.

That is the point **I** have in mind. **We** have got to use a little **common** sense **in** the way we **pay** our debt.

I am in favor of paying the debt, but I am in favor of keeping faith with that debt clear through to the end, not for 1 or 2 years of fakery, and then end it in disaster and default.

The CHAIRMAN. Mr. Hanes there was some discussion as to how much of the tax burden is carried by people of less than \$5,000.

It might be interesting to add that people with net incomes under \$5,000 have 80 percent of the income and pay approximately 48 percent of the tax.

People with incomes of over \$5,000 have 20 percent of the income and pay approximately 52 percent of the tax.

Mr. Hanes, we are very grateful to you for having come.

Mr. HANES. I was glad to come.

Thank you.

The CHAIRMAN. Our next witness is Mr. Laylin.

Will you state your full name, your residence, and your business?

STATEMENT OF CLARENCE D. LAYLIN, TAX COUNSEL OF THE OHIO CHAMBER OF COMMERCE, COLUMBUS, OHIO

Mr. LAYLIN. Mr. Chairman and gentlemen of the committee, my name is Clarence D. Laylin. I live in Columbus, Ohio, and am a lawyer. I appear on behalf of the National Association of State Chambers of Commerce. That is a federation of separate and autonomous State organizations, each of which is concerned primarily with the advancement of the business of its own State, and with the local problems of that business. But there are a few subjects of national and common interest which have drawn these State chambers of commerce together into this national association for the interchange of information and the formulation of opinions. Prominent among these subjects is Federal taxation. It has been my privilege to serve as chairman of the association's subcommittee on Federal taxation, on which I represent the Ohio Chamber of Commerce.

The composition of the State chambers reflects the business communities of the several States, and varies somewhat from State to State. Speaking generally, the national association, through its constituents, represents an aggregate membership of about 35,000, including manufacture, trade, service, professions, and agriculture, and employing some 7,000,000 persons. Most of the members are small business units.

In the fall of 1945 it fell to my lot to discuss with you the then current thinking of the national association on Federal-tax policy.

The program of recommendations which was then presented has been rethought in the light of the legislation of that year and the intervening developments. The revised program has been thus far reconsidered and approved by 27 State chairs, each acting through representative groups. A few have not reported; but we should be able very soon to publish and, if desired by the committee, to furnish for your use a pamphlet setting forth the present views of the members of the association—views which, I assure you, are not the opinions of a few men, but rather the grass-root convictions of a multitude of businessmen, reduced to a common denominator by study, consultation, and conference with each other and with economists, accountants, lawyers, and other students of taxation.

Senator HAWKES. Mr. Laylin, may I interrupt you there to ask you how many State members you have. You say a few have not been heard from. I think it would be well right there to say how many there are.

Mr. LAYLIN. My recollection is there are 38, but in order to be accurate, I must say to you that one of our States, which is an empire rather than a State, the State of Texas, has three bodies which qualify for membership in this association. I believe another State has two. So I would not have the committee understand there are 38 States, but there are 38 organizations.

These studies and the recommendations which are emerging from them conceive of the Federal revenue system as a whole and envision a rather thoroughgoing revision of it. We think the time has come to consider the problem from that point of view.

We believe that the expenditures of the Government can and should be reduced by the Congress, even more drastically than as indicated by the approval of the report of the Joint Committee on the Legislative Budget, though we recognize the weighty factors which have to be considered and that many of them are beyond the control of the joint committee. So we look forward to a comprehensive tax reform which would reduce the intolerable tax burdens of the people even further than would H. R. 4700, the bill before the committee, and at the same time embody numerous technical corrections and reforms which are long overdue.

We favor the purpose of H. R. 4700 because it is a timely step toward what our association believes should be the ultimate, if not the immediate, goal of the Federal tax reform, which we believe is imperative. That goal, as we see it, is the prompt release of the country's economy from the shackles with which wartime Federal taxation now fetters it.

The businessmen for whom we speak know what they need to enable them to contribute, each in his place, to a sound and stable economy to lay the specter of inflation and to sustain the high level of employment which the country now enjoys. Foremost among their needs—especially those of the smaller operators—is equity investment capital. There can be no doubt about this. President Truman, in his message on the state of the Union, rightly emphasized the necessity of expansion of our industrial plant in order that the people might obtain at fair prices the goods and services which they demand. In many instances, in most instances, of new and small business units, the capital required for such expansion does not and cannot exist in the form of corporate savings, reserves, or surpluses, it must be found elsewhere.

If our economy is to remain free, if the American system which has been the envy of the world is to be maintained, there is only one place to go for the capital which is needed. For that is what we call venture capital, and it is not to be found in the banks or other accumulations of investment capital which must be placed with an eye primarily to safety.

Even in the cases of large and well-established companies, with firm credit, extensive borrowing would weaken financial structures, and risk bankruptcy. That the Government should furnish the required capital out of the proceeds of taxes or borrowings, as was done under the stress of war, is simply unthinkable to an American businessman,

for it would mean state socialism, and undermine our system. Individuals who are able and willing to take a chance, and they alone, could furnish this risk capital. Under present Federal tax laws such individuals are few and far between, for their losses are allowed only to a trifling extent, and their rewards in the form of dividends are doubly taxed until what remains to the risk investor is insufficient as an inducement. The fundamental reason, of course, is the high progressive rates of the individual income tax.

So we believe that immediate reduction of effective individual income tax rates is the most essential step in the total program of tax reform which we advocate; and, if all the reforms which find place in that program cannot be achieved at once, we believe that individual income tax reduction should come first. Such reduction should give substantial relief to taxpayers in all the brackets, and not be practically confined to the lower-income groups; for that kind of tax reduction would not do the job for the business economy that needs to be done.

Therefore, we support the main purpose of H. R. 4790 and would oppose with utmost vigor any such proposal as was put forward by the President and embodied in H. R. 4968, Mr. Dingell—the \$10-per-unit-credit device.

We also favor those provisions of H. R. 4790 which would end the discrimination between the taxation of family incomes as between community property and so-called common-law States. It is the high progressive rates of the Federal income-tax law that have contributed most prominently to the sense of injustice which is felt so deeply in most of our States and which have induced several State legislatures to attempt, with varying degrees of success, to change the most fundamental of their domestic laws. We think the proper remedy lies in the hands of the Congress, and that the bill sets forth a happy solution of the problem.

The program of tax reform which has been approved by our constituent State chambers of commerce would spread the effective individual rate reductions more evenly across the scale of the surtax brackets than does H. R. 4790, and would leave the exemptions of the present law untouched. We had thought that a more substantial reduction than the bill offers to middle- and higher-bracket taxpayers would be necessary in order to liberate venture capital and lift the brakes a little from the wheels of our economy. But our people are realists. They have learned the distinction between the ideal and the attainable. So I am confident they would want me to say that, despite their preferences, an income-tax-reduction measure that would extend relief in an amount as substantial as would this bill, and would distribute that relief fairly among all individual taxpayers, and at the same time remove the community-property discrimination, would be a step in the right direction, and within the general framework of their thinking; and I am sure they would wish me to congratulate the Congress upon its determination, as evidenced by the actions of the House and your committee thus far, to enact legislation of this kind which will be effective this year.

It has been intimated that your committee may find it necessary to lessen the amount of the reduction accorded by the bill as it now stands. I have already hinted that those whom I am representing

would be opposed to that, as they see no revenue necessity for it; but, if any such modification is considered, we strongly urge that the adjustment be made proportionally among the taxpayers, so that the amended bill will still reduce the burden of all the taxpayers with real effect as to all of them. Unless substantial relief is accorded to middle- and higher-bracket taxpayers, as well as to those lower in the scale of incomes, the tax reduction will fail to accomplish the full measure of the economic benefits which are so greatly needed.

We have noticed with concern the proposal that some of the estimated revenue loss that individual income-tax reduction would produce be made up by the enactment of another excess-profits tax, modeled after the war tax of that kind. Our position with regard to such a tax was made known to you in 1945, when you were considering the repeal of the war tax. We then agreed with Secretary of the Treasury Vinson, who told this committee that the excess-profits tax was a wartime emergency measure, not suited to peacetime conditions. He said that it had an "erratic and in many instances an inequitable character."

He declared:

The difficulty is that calling profits excessive does not make them excessive. Calling profits normal does not make them normal.

And he spoke of the economic effects of such a tax in words that are significant today:

We are starved for new hotels, new theaters * * * and the like. The best defense against the use of our wartime savings to bid up prices on these scarce items is to remove the security. * * * To this end, elimination of the reverse influence of the excess-profits tax will make a real contribution.

Our opinion remains the same today; nor would it be changed by any proposal to limit the coverage of the exaction. As the Secretary said, experience has shown that it is simply impossible to devise any fair, equitable, and workable measure of normal profits. A tax on so-called excess profits could be either shifted to consumers or absorbed by the taxing corporation, depriving it of capital which it might otherwise need for expansion or replacement of facilities, and in either of these events it would be distinctly inflationary.

So we think that your committee should reject any suggestions looking to engrafting an excess-profits tax upon this or any other bill for the immediate reduction of individual income taxes. As I have said, our association is not wedded to every detail of H. R. 4790, but we do advocate the prompt enactment of a law which would embody the principles I have tried to describe—those which, to a considerable extent, are found in the bill.

It seems to be thought by some that Federal tax reduction would have an undesirable inflationary effect, and feared by others that deflation may be so imminent as to limit the extent of prudent rate reduction. These are speculations into which I do not pretend to be competent to enter. Our economists tell me that both inflationary and deflationary pressures are constantly present; that so long as there is scarcity of needed goods and services and enough money to spend, the inflationary pressure is likely to continue dominant; that the antidote for that is more production, which would be stimulated by tax reduction. Investment capital, though the temporary shift from Government spending to corporate spending for capital

goods would interject a temporary lag into the process; and that the supposed inflationary effect of release of buying power would be offset to a considerable degree by the tendency toward off-wholesale demands for higher wage scales. They say there, there are indeed signs of leveling-off—perhaps of some deflation in certain areas of the economy—but that there is no present basis for fear that the contemplated tax reduction will unbalance the national budget.

But the program of the National Association of State Chambers of Commerce, of which the particular bill of course (which your committee is considering is a part, looks forward to a sound tax system as a prerequisite of a stable economy. Such a tax system should be one to inspire confidence, not one which hangs like a millstone around the neck of enterprise. It should be devised and maintained with a view to approaching permanence, and not shift, like a weathervane with every wind of rumor or apprehension. There may be some types of taxes in our Federal system which call and should be quickly adjusted to marked changes in the economic climate. But the income tax, about which I have been speaking, is not, in our opinion, one of these. So far as that tax is concerned, the policy we favor is to get as quickly as possible to a sound basis, and stay there.

We realize fully that the key to real tax reform is to be found in reduced Government spending. We realize, too, that reduced spending is not the responsibility of this committee, save in the important sense that, curtailed revenues will strongly tend to reduce expenditures. We realize, finally, that reduction of expenditures may well involve more than mere appropriations. Nevertheless, the businessmen of the country, insofar as they speak through the association which I represent, expect to continue to press toward greater economy, believing that to be essential to the common welfare. We believe in a balanced budget, in a systematic reduction of the public debt, and in a realistic approach to the problems of foreign relief. We believe that America must keep herself strong in these troubled times, and rigorous elimination of whatever is wasteful or extravagant in the use of money exacted from the people by taxation is an indispensable means of so doing.

Believing as we do, the Association of the State Chambers of Commerce has been formulating the more comprehensive program to which I have referred. I think it only fair to the committee that I should here summarize the main points of that program, even though some of them are not directly germane to the subject under discussion this morning; for there could be no better way to acquaint you with the extent of our studies and the general tenor of our beliefs, which are the background against which I have spoken.

First. Reduce individual income-tax rates. The bill before you does that. Our ultimate objective is a maximum combined bracket of 50 percent at \$100,000.

Second. Continue withholding and current payment. That is done by H. R. 4790.

Third. Authorize married couples in all States to split their aggregate incomes, as in the bill before you.

We would also revise the income-tax treatment of capital gains and losses; lower and make technical corrections in the estate and gift taxes; repeal or amend some of the selective-excite taxes, but for the time being continue to rely upon the excises for substantial revenue;

reduce the corporation income-tax rates, as soon as revenue **requirements** permit, and smooth out the notches of the tax on **small corporate incomes**; alleviate the double taxation of dividends; substitute a lengthened carry-forward period for operating losses for the present carry-back and carry-forward combination; abolish the tax penalties on intercorporate dividends and consolidated returns; ameliorate the rigor of section 102 of the code; liberalize the allowance of **depreciation** and of research and developmental **expense**; and make needed technical changes in the tax treatment of stock-purchase options and pension and profit-sharing plans.

This is not the time nor the place to submit the specific **recommendations** which the **State** chambers of **commerce** have worked out over a **period** of years on these and other subjects. But we **do** want you to now the length and breadth of **our** deliberations, the depth of our convictions, and the height of **our** hope that we may be of assistance to the Congress in devising a sound peacetime revenue structure for our country. When we say, as I have said, that immediate reduction of all individual income taxes is imperative, and that we **urge** that the legislation to that end which has originated in the other **Chamber** be completed here without receding from the extent of the reduction or departing essentially from the principles involved in it, we want to be understood as reserving **our** considered view that the task of tax reform, though well started, will not be **complete** when this measure shall have become a law.

The **CHAIRMAN**. Any questions?

If not, thank you very much, indeed, **Mr. Laylin**. It is a very fine statement.

Mr. LAYL. Thank you.

The **CHAIRMAN**. We will hear **Mr. Marsh** of the People's Lobby, Inc., before lunch.

Will you state your **full** name, your residence, and your business.

STATEMENT OF **BENJAMIN C. MARSH**, EXECUTIVE SECRETARY,
PEOPLE'S LOBBY, INC., WASHINGTON, D. C.

Mr. MARSH. My name is **Benjamin C. Marsh**, and you asked for my **business**. I am one of the few people that **admits being** a lobbyist. I represent the People's Lobby, Inc., here in **Washington**, and I just started yesterday morning **my fourth** decade here, and still have hopes we will do something intelligent before we **get** through.

Senator **HAWKES**. **efore** **Mr. Marsh** proceeds, are you going to explain a **little** bit more what the People's Lobby, Inc., **is**?

Mr. MARSH. I would be very glad to.

Senator **HAWKES**. I would like to know.

Mr. MARSH. With the permission of the chairman, of course.

Senator **HAWKES**. Not a long explanation, but I would like to know **how** many people are in this.

The **CHAIRMAN**. We should be on the first floor right now, technically.

Senator **HAWKES**. All right; go ahead without it.

Mr. MARSH. Perhaps instead of going into that, **Mr. Chairman**, I could read into the record Spot News of **King** Features **Syndicate**.

The **CHAIRMAN**. Never mind reading it, we will just insert it in the record.

Mr. **MARSH** (reading) :

Washington's No. 1 lobbyist labors for, not against, the people.

I am glad to accept that verdict of the headline.

(The article is as follows:)

[Spot News-King Features Syndicate, Cleveland 14, Ohio, December 27, 1947]

WASHINGTON'S NO. 1 LOBBYIST LABORS FOR, NOT AGAINST, THE PEOPLE

(By Jay Richter, Central Press Correspondent)

WASHINGTON.—As the April showers bring May flowers, so the return of Congress to Washington sprouts lobbyists all along the shores of the imperturbable Potomac.

Some citizens are sure to point out that the comparison is a bad one.

It is indisputable that flowers smell much better than lobbyists. However, the notion abroad in the land that all lobbyists specialize in extracting low promises for high prices is not always based on hard facts.

There are exceptions, and one of these is Benjamin C. March.

Not that there's anything odd in his being a lobbyist. There are 1½ of these professional persuaders for every one of the 531 Congressmen you elect. That's counting only those who admit it and register, as a new law requires. It is estimated that there are at least again as many invisible lobbyists who call themselves by sweeter names.

Ben March is a lobbyist who readily admits it. As a matter of fact, he proclaims it.

Ben even lobbied for the law which requires lobbyists register, and then he was the first to sign up, making him Washington's No. 1 lobbyist. A rough comparison would be the prohibition days bootlegger who worked for repeal * * * on his own time.

The gaunt, slightly stooped figure of the 70-year-old dean of capital lobbyists bears little resemblance to others of ilk on any score sheet. In 27 years at the helm, he has never given a cocktail party, a fancy dinner or promised a favor to the great and near-great.

March represents the People's Lobby, Inc., which he himself founded in the early twenties. It is supported by members' dues and voluntary contributions. His office is a cluttered, book-ridden and manuscript-strewn room of an F Street building down at the foundations.

A worn mimeograph machine in one corner, which he personally operates, is one of the most prolific in town. It is estimated that he has issued nearly 5,000,000 pamphlets, bulletins, open letters, press releases, and related materials.

The dean's clients are the common people.

In their behalf, he trumpets for the lobby's program of a mixed American economy composed of cooperative associations, private enterprises, and public ownership.

Probably no one in Washington has advised, pleaded with even berated, as many Presidents, a half-dozen of whom he has known personally. From William Howard Taft to Harry Truman, March has given freely, and publicly, of his counsel upon every important problem of the day.

The Dean is bombastic on paper.

"It is your duty, Mr. President," he recently advised the White House, "to drive the rapacious horde of profiteers out of the temple of democracy—even as Christ drove the money-changers out of the temple, in His day on earth—to protect the common people."

Virtually, everybody but common people or consumers at one time or another are punctured by the dean's free-swinging pen.

Ben recently called for a consumers' session of Congress to enact legislation to protect consumers from the unbridled rapacity of most business enterprises and big landed farmers, and the short-sighted boomerang policies of many major labor unions.

March is not a crackpot. Congressional committees frequently call upon him for testimony on important bills. His quiet conversational charm and quick wit contrast sharply with his bombastic writing style.

He is a respected friend of Washington newsmen who are attracted by his ability to turn a neat phrase, such as this favorite: "More lobbyists are ruined by the salon than the saloon."

In contrast to most other lobbyists, notably **representatives of wartime contractors**, the dean of them **all** believes **lavish social entertainment constitutes** poor lobbying. **When he gains entry to an office on Capitol Hill, his approach is direct and businesslike.**

"**People's Lobby, Inc.,**" **he is likely to begin, "represents virtually everybody, but property owners who can afford to take care of themselves. Now, what you ought to do, Mr. Congressman * * *"**

In an effort to **"unconfuse" a Senator on the inflation problem, the dean observed that "You can't give champagne prices for water stock. We'll have to exercise self-discipline, or we'll get posed police power."**

It is no secret that many lobbyists receive considerably more than the \$12,500 annual salary of the lawmakers they are paid to influence.

The records show, for example, that 14 representatives of electric firms receive pay checks which average \$19,170 annually. The annual average salaries of 58 lobbyists representing agriculture is \$13,040.

Labor lobbyists get comparatively low pay, but the AFL spent more than three-quarters of a million dollars in an effort to defeat the Taft-Hartley bill.

Ben Marsh, on the other hand, resists the efforts of People's Lobby, Inc., to boost his nominal annual pay of about \$1,800 yearly. Instead, he dips into modest savings to meet high living costs.

"My pay is about the average of the people I represent," he says, "and I want to know all their problems by sharing their thoughts and troubles."

Mr. Marsh. Congress must not expect to fool the people, by giving small income brackets a token reduction in taxes, and one to the wealthy, which will enable them to make campaign contributions of the legal maximum for a dozen to 20 relatives or friends.

A small tax reduction also, is not an acceptable substitute for the necessary price reduction of 10 to 15 percent, and measures to stop inflation, such as the Chairman of the Federal Reserve Board has recommended.

If you do not mind, Mr. Chairman, I would like to interpolate a little bit as I go along.

I have been so interested in Mr. Hanes' testimony this morning and the questions. You have been discussing the reduce purchasing power of the dollar. Sure. We call it inflation. What has Congress been doing in the 30 years I have been here so we have not gotten an economic system to prevent inflation?

I leave that question to be answered in November.

In every prosperous year, such as 1946, 1947, and probably this year, the national debt should be reduced by two or three times the interest on this debt, which means by \$10,000,000,000 to \$15,000,000,000.

In the past, Mr. Chairman and members of the committee, I have submitted a great many statistics. I am not going to do that today because you have all you need, but I would just like to outline briefly the principles which we think should be incorporated in this bill, and you will recognize it means revamping quite generally the bill which the House has passed.

The revenue bill you are now considering should:

1. Retain personal income tax rates on income over \$6,000 if not over \$5,000.

2. Retain present profits taxes.

3. Restore wartime excess-profits-tax rates.

4. Repeal some excise taxes and reduce others as recommended by Mr. Matthew Woll in his minority report to the House Ways and Means Committee, as a member of the Special Tax Study Committee.

I did not want to burden the record with the details of those recommendations, but they appear on page 65 of the report to the House

Ways and Means Committee submitted November 4, 1947, and they include repealing excise taxes, starting with oleomargarine, which total \$1,058,000,000

I think **Mr. Woll** was the only signer of this minority report.

They recommend 50 percent reduction in excise taxes of \$436,000,000, which means a total amount of reduction from excise tax reduction.

Senator Hawkes. May I hear you repeat that again? Fifty percent reduction in all excise taxes or just certain ones?

Mr. Marsh. He recommended the repeal of excise taxes totaling \$1,058,000,000. **Mr. Woll** recommended reducing by 50 percent excise taxes totaling \$436,000,000.

Senator Hawkes. That would not touch them all because you know last year we collected about \$7,274,000,000 excise taxes.

Mr. Marsh. He did not try to cut them all off.

Senator Hawkes. I just wanted to be sure.

Mr. Marsh. But his total he recommended was a reduction from excise taxes of \$1,494,000,000.

5. Provide adequate penalties for failure to distribute as dividends the percent of profits the law requires, and close loopholes for evasion.

6. This bill should also impose at least a small tax of around 1 percent on the value of land, exclusive of improvements therein and thereon.

Land speculators have always been the beneficiaries of Government policies and expenditures, and the selling price of farm and city lands has increased since 1932 by at least \$35,000,000,000, probably nearer \$40,000,000,000.

The tax exempt value of land in the United States is now between \$80,000,000,000 and \$85,000,000,000, and the selling price of land is usually about the last to go down, in a deflationary period.

It is time Congress began taxing these tax-exempt land values.

Mr. Chairman, there was an item in the paper since I wrote this which I think will interest this committee, and the last suggestion I have made bears on it.

The Government wants to get what is known as the "Nevius tract," a large tract of land. An appraisal of \$850,000 was put on it, out of which the Government would get, according to the press reports, \$150,000 tax; but now they have tried to raise the charge to the Government by another \$750,000 to make a total of \$1,600,000.

If you had the heavy taxation of land values, the Government could buy that land for a much lower price, and I sometimes wonder when the manufacturers and big taxpayers as well as little ones of this country will wake up to the fact that the extortion of land speculators on industry and consumers is extremely heavy.

Congress, properly provided in the Reorganization Act for a budget, but this has been more honored in the breach than in the observance.

It is however a sound policy, and a bipartisan insistence upon its observance in an election year would be a welcome assurance of national unity. Intelligence by bipartisan action accepted the responsibility

of the Federal Government to see that people do not starve, at least too fast, by enacting unemployment compensation and similar legislation, thought the coverage for unemployment compensation should be extended.

The acceptance of this principle should determine tax policies.

A certain sum, varying in different areas, is necessary to maintain a decent standard of living.

Any tax, of whatever sort, excise, consumption, or unemployment, levied on incomes below this minimum, impairs the health of such a family.

Just as it is arrant nonsense to increase wage rates, when the cost of living is permitted to increase promptly so as to nullify the wage increase, it is folly to levy taxes which result in reducing spendable incomes below the minimum requisite for a health standard of living.

While Congress does not plan this year the coordination of Federal, State, and local taxes, your tax bill should make it clear by its tax policy Congress does not approve tax policies of most other taxing authorities which levy the same rate of taxation on buildings, and other labor products that it does on land values, for this means the enrichment of land speculators, and the impoverishment of citizens, for whose well-being the Federal Government, not the State, not the local, has accepted responsibility.

We shall probably have a drastic capital levy or repudiate much of the national debt.

I would like to read in a few lines from an editorial in the United Mine Workers Journal of July 15, 1946.

As you all know, John L. Lewis is not known as an extreme radical, but here is what he says:

Sooner or later thinking leaders of labor are going to awaken to the fact that, regardless of what has happened in America before, capital levy tax is the only way out of the financial mess in which this country finds itself.

Of course, it is a good deal worse now than nearly 2 years ago when that editorial appeared in the United Mine Workers Journal.

Mr. Chairman, I would like to submit a tentative draft of a bill to provide for a tax of 1 percent by the Federal Government on the unimproved value of land of all sorts in the United States.

The CHAIRMAN. It will be accepted and filed.

A BILL To provide revenue for the defense of the United States, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That, beginning July 1, 1948, there shall be assessed, and collected 1 per centum of the value of all land situated in the United States, its Territories, possessions, and the District of Columbia, exclusive of the value of improvements therein or thereon, and shall be collected each July 1 thereafter by each State, Territory, possession, and the District of Columbia from the holders of legal title to such land area within their jurisdiction and transmitted immediately to the Treasury of the United States.

Sec. 2. "Value of land" shall, for the purposes of this Act, be the sum of the annual rental value of the land or area, exclusive of the value of improvements thereon or therein, multiplied by twenty, or the full assessed value thereof. "Improvements" shall, for the purposes of this Act, mean all buildings, structures, machinery, docks, wharves, bridges, canals, roads and highways, fences, tillage, fertilization, crops, orchards, groves, forests growing or planted thereon or therein. "Holders of legal title" shall, for the purposes of this Act, mean the persons, corporations, associations, partnerships, syndicates, trustees, or any agent or proxy who may have legal title to the land.

Sec. 3. This Act may be cited as the "Land Values Taxation Act of 1948."

Mr. MARSH. There is one final suggestion I would like to make. You are all interested in reducing expenditures, and we all are.

Congressman Engel, of Michigan, was good enough to send me a statement he read into the Congressional Record which points out that there are about five captains, and five majors, and three lieutenant colonels, and one and one-half colonels in the Army for every second lieutenant, which seems a very large number.

I sincerely hope in considering that provision, I am referring to the Joint Reorganization Act, your own law, you will realize that a good deal of saving can be made in the Army expenditures, because we certainly do not seem to need 21,177 captains, and 20,706 majors, and 12,637 lieutenant colonels, and 4,002 colonels.

We have enough generals to run for the presidency as it is without keeping colonels, captains, majors, and lieutenant colonels on top.

I would like to refer, in conclusion, to the erroneous statement which Mr. Hanes made in his very able presentation, that Europe was going to the "how-wows" with what he calls socialism.

Here is an editorial from yesterday's New York Herald Tribune. I would like to incorporate some figures from the current issue of United News and World Report.

You all know David Lawrence is not an extremist. He pointed out, under the degree of socialistic methods adopted in Europe, many European countries' industries have the greater increase in production. Of course, the lowest in two or three which were severely bombed.

In Britain output of goods has gained 9 per cent in 1946 and is back to a point only 10 percent below 1937—a good year. It is better than 1938.

Steel production in Britain reached a new high in January, and records are being set in the output of tractors, automobiles, machinery, and chemicals. However, a shortage of scrap threatens to cut steel output by 10 percent before the year is out. Coal production is increasing, and coal can now be exported for the first time since before the war.

In France, production is better than in 1938 and only 7 percent below the prosperous year of 1937. Last year 20 percent more goods were turned out than in 1946, and output still is rising.

In January French gains over 1938's average monthly output were 20 percent in coal, 5 percent in steel, 38 percent in tires, 15 percent in paper. Output of textiles rose 35 percent last year, but still is below prewar. Textiles, perfume, and wine are major export items.

Italy managed last year to step up production by 35 percent, but it still is 34 percent below the average of prewar years. Specifically, the Italians last year increased steel output by 42 percent, coal 20 percent, automobiles 120 percent, and cement 60 percent. But there are still 2,000,000 unemployed in Italy, and worker efficiency is only about three-fourths what it was before the war.

Total production in the United States-British zones rose only 17 percent in the last year, to put the area at 40 percent of the 1937 level. Ruhr coal output is increasing, but other industries are faltering. Germany cannot even supply parts for machinery previously sold to other countries.

The depression level of German industry, plus lack of trade with eastern Europe, is handicapping continental recovery efforts.

(American military government has opposed social ownership in Bizonia.)

I would also like to point out to you that after the People's Lobby put the matter up to the State Department rather vigorously, we got a point-blank statement that under the European recovery plan there was no intention to discriminate against social ownership in any country when adopted by the free will of the people.

Mr. Chairman, to my mind, this session this morning is one of the most interesting of 30 years I have been here.

It reminds me of a book I read a few years ago, The Twilight of Capitalism, and that is what it is.

What is going to evolve, I do not know. Our present system is done. If it were not for **ERP** and cumulative purchasing power during the war, we would be in terrible condition.

One of our board of directors, a friend of mine, wrote a book, **The Depression Decade**, what happened under **the New Deal**. He did not criticize it, but the title of the concluding chapter of his turns the trick—War to the Rescue.

Mr. Chairman, after 10 years of the **New Deal** in 1942, returns to ownership and control of property in the United States had increased four times as much as to labor. You cannot touch the tax problem today except as part of the whole economic system. We have got to make changes gradually. My own conviction is now is the time to begin—and Senator George has been listening to me for decades very patiently. The big job is how to combine the unquestioned benefits of private initiative with the need of larger collective ownership.

Thank you for your courtesy.

I do not expect you to accept all our suggestions, but the ones you do accept will be gratifying to a very long-suffering people.

The CHAIRMAN. I want to thank you, Mr. Marsh.

We will recess until 2 o'clock.

(Whereupon, at 12:35 p. m., a recess was taken until 2 p. m. of the same day.)

AFTERNOON SESSION

(The committee reconvened at 2 p. m., upon the expiration of the noon recess.)

The CHAIRMAN. The meeting will come to order.

Is Dr. Roos here?

Will you come forward please, Doctor.

We are very glad to have you, and are glad that we were permitted to go ahead this afternoon so that we could hear you.

Will you be seated, Doctor, and give the reporter your full name, your residence, and your occupation?

STATEMENT OF DR. CHARLES F. ROOS, PRESIDENT, THE ECONOMETRIC INSTITUTE, NEW YORK, N. Y.

Dr. Roos. My name is Charles F. Roos. I live at 817 Fifth Avenue, Manhattan, N. Y.

I am president of the Econometric Institute, Inc., a business research and consulting organization, with offices at 500 Fifth Avenue, New York City.

I am also president of the Index Number Institute, Inc., which publishes the Irving Fisher Price Index and a weekly business service known as Economic Measures.

The CHAIRMAN. Proceed, please.

Dr. Roos. I am an economist, statistician, and mathematician by education and training. I received my B. A. degree in 1921, my M. A. degree in 1924, and my Ph. D. in 1926 from the Rice Institute, Houston, Tex.

After receiving my doctor's degree, I spent 15 months in study at the University of Chicago and 9 months more at Princeton and Chi-

age Universities as a fellow of the National Research Council. I was then appointed assistant professor of mathematics at Cornell University.

In the same year, 1928, I was elected secretary of section K, economics, sociology, and statistics, of the American Association for the Advancement of Science.

In 1931 I left Cornell University to become permanent secretary of this scientific organization.

In 1933 I left this position to do special research on changing economic conditions as a fellow at the Guggenheim Memorial Foundation. While I was engaged in this study in London, England, I was invited to become principal economist and research director of the National Recovery Administration in Washington.

I left this organization in September 1934 to become research director of the Cowles Commission for Research in Economics, which was then in Colorado Springs, Colo., but is now affiliated with the University of Chicago.

In 1937 I left the Cowles Commission to set up my own research and consulting business, which, as I have said, is known as the Econometric Institute, Inc. By way of explanation, I may add that I helped to coin the word "econometric" to mean primarily economic measurement or the development and testing of economic theory. In 1939 I bought the Index Number Institute from Prof. Irving Fisher.

My organizations, composed of about 80 persons, have always specialized in the forecasting of national income, and its components, incidentally, and production, and in the translation of these forecasts into demand and supply and price levels for industry.

Today there are several hundred major corporations in all fields of business activity which my organizations serve. I believe that they enjoy the unique position of having always identified correctly the trends of production and income and of having always forecast the turns a few months in advance.

For example, in November 1936, before I organized the Econometric Institute I questioned the continuance of the upward trend of business. I began to turn bearish on February 9, 1937, and on September 9, 1937, predicted business and financial panic. The Econometric Institute, which began business on April 1, 1938, indicated on May 9, 1938, that the bottom of business had been reached. Financial and commodity markets confirmed this forecast nearly 6 weeks later.

The first new steel capacity to come into production during the war resulted from a forecast of the Econometric Institute in early 1939 that the economy was just entering the capital goods or boom phase of business for which additional steel capacity would be needed.

Beginning in November 1943 forecasts of income and production were made only by the Index Number Institute. In February 1944 this institute forecast postwar industrial production as measured by the Federal Reserve index at 170 and 185 percent, respectively, of the 1935-39 average level in the first two postwar years, full employment, rising wages, steel and other material shortages, and inflationary price trends.

The production index averaged 170 in the first postwar year and 187 in the second. The accuracy of the other forecasts is well known.

Late in 1946, when bearish forecasts were sweeping the world, the institute's studies indicated rising production, rising income, and rising prices and its forecasts to that effect are on record.

•On November 17, 1947, the institute indicated that the high of the price level for several years would be made in the period of February to May of 1948.

We have no crystal balls and no telephone connections with God. All we have to offer is tested economic measures of business and financial pressures which are likely to maintain or change a business trend. The expected rates of taxation are of fundamental importance, particularly when business is operating at capacity.

We have found that in making scientific forecasts of business a good starting point is the detail of the Federal Reserve Index of Industrial Production.

As you know, that is an index of physical volume; not of dollars, but of units.

Industrial production is related to a man-hours worked and the man-hours times the average wage per hour yields pay rolls. Moreover, man-hours required in the distribution and service industries are closely related to this industrial production and can be forecast from it. Man-hours in all industry, together with hourly earnings, determine the demand for agricultural products, and the relation of this demand and export demand to the supply determines the price level of agricultural products and thus farm income.

* In 1947 wages and salaries of workers engaged in the production and distribution of industrial and farm products and in government constituted about 71 percent of the personal income of the entire population. Entrepreneurial profits of shopkeepers, professional persons, and others working for themselves are closely related to this income and in 1947 accounted for about 12 percent more of personal income.

Interest payments, rents, royalties, pensions, unemployment insurance, military and other bonuses, and dividends constituted the remaining 17 percent. We have charts which enable us to translate industrial production into the various components of income and so from forecasts of production to arrive at forecasts of income.

The industry break-down as presented by the Federal Reserve index of industrial production can be subdivided and rearranged as shown in chart I.

Now, I have here a copy of that chart.

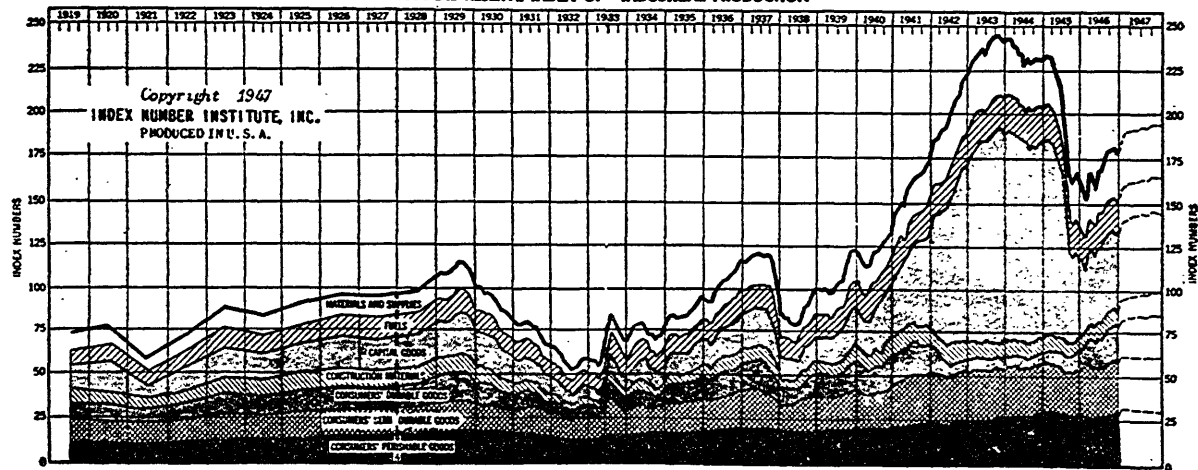
The CHAIRMAN. May we have it for the record?

Dr. ROOS. You may have it for the record.

(The chart referred to will be found on p. 139.)

CHART I

FEDERAL RESERVE INDEX OF INDUSTRIAL PRODUCTION



REDUCTION OF INDIVIDUAL INCOME TAXES

Dr. Roos. In this form the highly variable segments are pointed up, and it is thus shown wherein lies the core of the forecasting problem.

Even a casual glance at the chart shows that the highly variable components of production are capital goods, construction materials, and consumers' durable goods. Indeed, production of consumers' perishable goods and consumers' semidurable goods can be forecast even by a novice with relatively good accuracy from population data and growth in consumption relative to this population. On the other hand, the forecasting of production of the durable-goods components is much more difficult. Yet, if one is to make a useful forecast of total production and, as I shall show, of national income, he must make a reliable forecast of production of these durable goods.

The capital-goods component, which is the most variable segment of economic activity, is a unit-volume index. It may be forecast directly from the level of demand for consumers' goods and construction materials, the ratio of this expected demand to capacity and the rate of interest on long-term bonds.

A better forecast can be obtained by working with the dollar figures representing producers' durable-equipment expenditures and their converting these forecasts of dollar expenditures to unit volume by means of a price index of machinery and machinery products.

Chart II taken from my paper, The Demand for Investment Goods, which I presented in December 1947 to a joint meeting of the American Economic Association and the Econometric Society, shows the relationship that exists between expenditures for producers' durable equipment and a composite of several variables 6 months previous. The chart shows that producers' durable equipment can be forecast 6 months ahead from present values of (1) corporate profits, (2) interest rates, and (8) the ratio of the Bureau of Labor Statistics index of prices of commodities other than farm products to the same Bureau's index of prices of metals and metal products. The agreement between the expenditures and the forecasting variable is as close as one finds in the physical sciences, except in the war years when we know that the War Production Board purposefully held down equipment activity by licensing.

(The chart referred to will be found facing this page.)

Dr. Roos. Despite the sharp increase in bond yields brought on by the tightening money policy of the Federal Reserve Board and the excessive-tax rates of the present period, corporate profits and relative prices are sufficiently strong to indicate expenditures for producers' durable equipment at an annual rate of about \$17,000,000,000 during the first half of 1948. You will notice from the chart that this would be below the figure for 1947. However, this amount would be augmented by deferred demand of about one more billion dollars.

In the second quarter of 1948, however, if present tax rates continue, corporate profits are likely to decline as a result of increasing competition and the excessive drain on consumer purchasing power by Treasury receipts, coming at a time when wages and other costs are increasing. This same competition will prevent nonfarm prices from continuing outrun prices of metals and metal products.

I understand that a steel price hearing is in progress now to ascertain the reason for the recent rise in prices of steel. My earlier testimony indicated that such a rise would occur since I predicted that prices of

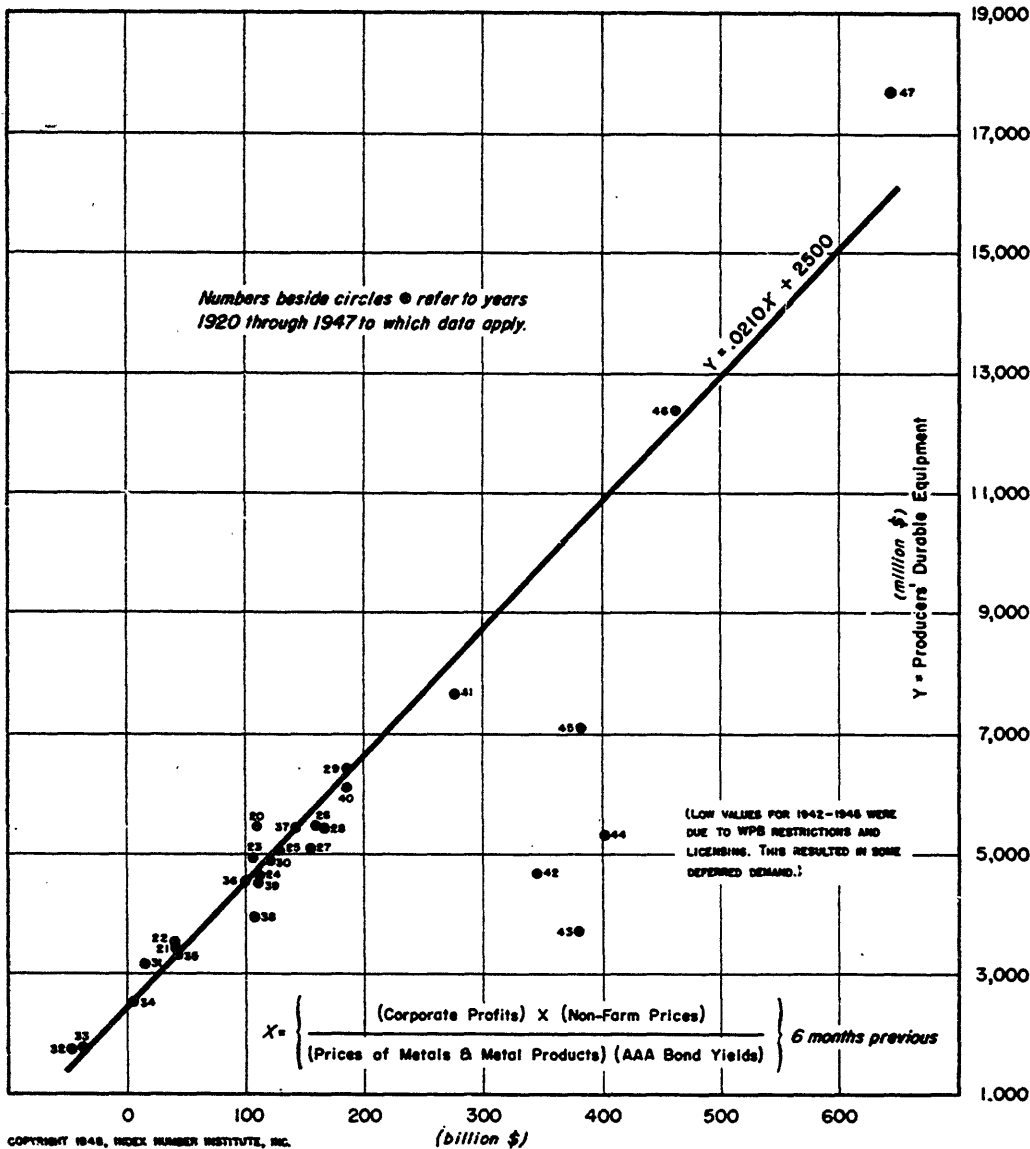
ECONOMIC MEASURES

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PRODUCERS' DURABLE EQUIPMENT VS CAPITALIZED CORPORATE PROFITS AND RELATIVE PRICES



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metals and metal products would advance more in the present phase of the cycle than the prices of nonfarm products and other products.

Even if the Federal Reserve Board discontinues immediately its policy of tightening credit, interest rates are not likely to decline significantly in the face of heavy demand for capital funds by industry to pay for equipment already on order.

The CHAIRMAN. Doctor, can you tell us: Is there a normal lag between goods on order and payment for goods on order?

Dr. Woos. In the case of capital goods, it is about 6 months. But the lag varies, sir, with the size of the backlog.

Title CHAIRMAN. We have that coming up in connection with our ERP project, and it is relevant, because we are trying to estimate on which budgetary year the expenditure will fall.

Dr. Roos. Perhaps I had better qualify the statement, then, a little bit more.

* The lag, particularly at the present time, when backlogs are still large, is variable, and, as I said, depends upon the size of the backlog and also on the kinds of goods being produced.

The CHAIRMAN. Would it depend upon the size of the material? I mean, very heavy equipment? Would that not take longer to fabricate?

Dr. Roos. Yes, heavy electrical motors, or heavy generators, require up to 2 or 3 years for production; freight cars a matter of a few months.

The CHAIRMAN. Specially designed equipment, I suppose, would take--

Dr. Roos. Longer than ordinary equipment. A locomotive, I think, takes 6 or 7 months. On the average, the lag is around 6 months before a change in orders shows up in production.

The CHAIRMAN. Pardon me for interrupting.

Dr. Roos. Consequently, on the basis of present tax rates and present Federal Reserve Board policy, a very sharp decline in production of producers' durable equipment, must be forecast to begin in the third quarter of 1948.

Industrial construction, which comprises a large segment of the construction materials component of production, can be forecast by a similar formula. Perhaps I should use "approach" instead of "formula." Some people don't like the term "formula."

One needs only to replace the price index of metals and metal products by the cost of construction. Of course, the statistical constants are different. By that I mean that a line of relationship is obtained which has a different slope. But otherwise the approach is the same.

In the case of construction it is, however, also desirable to introduce the ratio of production to plant capacity, under 30 years of age. These factors, as presently constituted, indicate new highs for industrial construction during the first 6 months of 1948. And may I just add that at the year end, construction contracts were still going up, as they should, according to the forecasting approach. However, present tax rates, plus tightening money markets, unless speedily corrected mean sharply lower volume of industrial construction after the third quarter of 1948.

The outlook for residential building, another component of the construction-materials segment, can be forecast from the difference

between **the** number of families and **the** number of existing housing units, present average rents on existing rented **properties**, interest rates, construction costs, and disposable income or income after personal taxes.

Despite the fact that the number of families exceeds **the** number of nonseasonable habitable family units by a few hundred thousand units, **the** prospects for residential building are poor under the present **con-**
fiscatory personal-tax rates, rising interest rates, and **the** low return on competitive **existing** rental property. **However**, a large backlog of public **building—schools**, hospitals, office buildings, streets, sewers, roads, **et cetera—**is ready, and **con-**struction will start **as** soon as **building-materials** supplies ease.

Consequently, **the building-materials** segment of production is likely to remain near present levels or even rise slightly.

The remaining variable portion of production is consumers' durable goods. The most important variable for forecasting **the** demand for **these** goods is disposable income or personal income after taxes.

In **the** case of automobiles, the demand will exceed **the** supply even with present tax rates and a slight decline in income. On **the** other hand, **supply** already exceeds demand for electrical appliances and for a good portion **of the** furniture production.

Unemployment will develop very **rapidly in these industries unless the** burden **of** taxes is reduced.

For all consumer goods and services business tends to be easy **to** get and production and employment and personal income are high **when-**
ever production of capital goods, construction materials, and **con-**
sumers' durable goods are increasing or stabilizing at high levels.

Also of fundamental importance for determining personal income is **the** Federal fiscal policy.

At current tax **rates**, Federal **cash** receipts will exceed expenditures for **the** first 9 months of 1948 at an annual rate of 8 to 11 billion dollars, the exact amount depending **on** budget matters that have not yet been settled, which in itself **would** be highly deflationary. Such a rate of debt retirement would be equal to about **5** percent of personal income. It would mean that **5** percent of the public's purchasing power would **be** drained from business channels, **and** (1) **be** extinguished if used to retire bonds held **by** banks, or (2) converted into capital or savings, if used to retire bonds held **by** individuals or **corporations** other than banks.

Or to put the matter differently, this rate of debt retirement would correspond to a business corporation retiring its debt **at** the rate of 5 percent of its sales per year.

Reliable **forecasts of** personal income must take into account **the** following **conditions—**

The **CHAIRMAN**. Doctor, may I ask **you** if, out of your own experience, you have observed any repercussions **to the** effect that perhaps we are retiring our debt too rapidly under the present somewhat tender economic **picture?**

Dr. Roos. Yes. It is a question that we are asked about **all** the time when we **are** consulting with **corporation** executives. And as **I** testified earlier, we serve several **hundred**. I think the number **of** corporations is **in the** neighborhood of **350**—it may **be** as high **as** 875. We see the officers **regularly**. Somebody. in the office is

seeing the executives of at least three companies a day as a routine matter of visiting. And the question is of universal interest today.

The CHAIRMAN. I find, just from my own limited contacts, that small-business men, for example, are telling me that they are being called in by their bankers and being warned that perhaps loans may not be extended, or that perhaps they had better cut their loans a little more than had been anticipated, and that the bankers in turn take that position because they have become nervous about overly rapid official credit contraction and certain scary types of official propaganda. That is correct, . . . I think part of it is . . .

reaction to the tight money or credit condition. When you throw red meat to certain wild animals, you know, they become quite vicious quickly. And the Federal Reserve policy of tightening interest rates his last fall served as a piece of red meat to some of these bankers, and if you have a credit contraction that goes beyond what would be due to the change in the actual reserve conditions, and perhaps much beyond the intended situation.

Is that all, sir on that matter?

The CHAIRMAN. That is all.

Dr. Roos. As I started to say, reliable forecasts of personal income must take into consideration the following conditions:

(1) Changes in the expenditures by industry for durable equipment or plant construction: This is important because workers are employed in the production of these goods which do not immediately increase the supply of consumers' goods or services.

I mentioned earlier the lag between production of and orders for durable equipment; the lag for plant construction is longer than 6 months.

Workers in these industries receive income for the production of the investment goods, and use this income to bid for the available supply of civilian consumers' good and services. These investment expenditures by industry reached a level of \$21,600,000,000 in 1947, or nearly 10 times the 1933 level. A moderate decline of \$1,000,000,000 in these expenditures is expected in 1948, if the Knutson bill becomes law.

I might add that if there is no tax reduction, a decline of about \$3,000,000,000 for the year 1948 is indicated, and an annual rate of decline of about \$5,000,000,000 by the year end.

(2) Changes in business inventories: Income is created for the production of goods for inventories or the transportation of such goods but the consumers' supply at retail is not increased during the period in which this income is spent. Inventories in 1947 rose \$6,400,000,000 over 1946. They are today about normal in relation to sales, but somewhat unbalanced.

A substantial general increase from the current level would lead to later deflation.

May I just add, in explanation, a word on the term "unbalanced"?

We find that inventories of what we call nondurable goods are today about a billion dollars less than would be indicated by current sales and past relationships between inventories and sales. At the same time inventories of consumers' durable consumer goods are excessive by about a billion dollars.

And of course, it is the consumers' durable goods, primarily, that are affected by the income that would be released to consumer channels by this tax reduction.

(3) Changes in net exports: Similarly, production for net export creates current purchasing power unmatched by a civilian supply. Even with the full Marshall plan, these net exports will drop by about \$1,500,000,000 in 1948.

(4) Changes in the value of residential construction: While the consumer customarily pays down only a small part of the purchase price of a new home, the whole value of the construction represents income to someone. The value of residential building was about \$5,100,000,000 in 1947, it will rise to about \$6,000,000,000 in 1948 if the Knutson bill becomes law, and clear indications are given that rent control is nearing an end. It will drop to \$4,500,000,000 if present taxes are continued and strict rent control is extended for a long period of time.

(5) Changes in hourly earnings or wage level:

Wages and salaries form important parts of personal income. When fully reflected in personal income.

In preliminary negotiations with management, labor is asking for substantial increases. At the same time, there is an attitude on the part of management not to grant substantial increases. Increases of about 4 percent over the year-end level could be absorbed by most industries without price increases, provided labor output improved sufficiently to reflect the heavy capital expenditures of 1947. And you will recall from the chart that these expenditures were about 17.7 billion dollars, or 10 times the 1933 level.

Such an increase in hourly earnings, that is, 4 percent over the year end, without price increases or increased output per man-hour would substantially lower profits and consequently the demand for producers' durable equipment and plant construction late in 1948.

An increase in hourly earning of 4 percent over the year-end level under conditions of continued full employment would add about 4.5 billion dollars to personal income in 1948.

(6) Changes in the difference between income and expenditures of Government: Deficit spending tends to add to incomes in excess of the amount required to purchase consumer goods and services at current prices. On the other hand, debt retirement converts current income into savings which may or may not find an immediate outlet if the debt of individuals or corporations other than banks is retired. If bank debt is retired, the purchasing power may simply be extinguished. Fiscal policy becomes commandingly important whenever the sum of the changes (1) to (5), as listed above, is about zero.

Summing up, we find, under the assumption that the Knutson bill becomes law, that the changes (1) to (5) will be plus 2.8 billion dollars.

This means that Federal debt could be retired at this rate without contributing to inflation, or, for that matter, to deflation. A higher rate of debt reduction would be deflationary, and might be disastrous. A rate equal to \$10,000,000,000 per year which would be the starting rate for 1948 without reduction in tax rates, would be so deflationary as to cause severe unemployment and a decline in personal income.

Today the United States economy is in excellent health except for present fiscal and credit policies. Both threaten severe deflation and

unemployment. In other words, **the** economic future of this country is peculiarly today **in the hands of this** committee.

We have made forecasts of income and employment under **the** two assumptions regarding taxes: (1) **If** the Knutson bill is passed **by** the Senate and becomes law; **and** (2) no tax reduction **materializes**.

In the first case, that **is**, the Knutson bill becomes law, we forecast that personal income, which was at an annual rate of about **209.7 billion** dollars in **December 1947**, will average about 210 billion dollars during the calendar year **1948**. In the second case, that is if there is no tax reduction, **personal** incomes will average about 200 billion **dollars**, or \$250 per family **less**. **The** wide difference is due to the collateral adverse effect on employment in the **durable-goods** industries, brought **about by** the sharply deflationary effect of the debt retirement at a suicidal rate.

The CHAIRMAN. Are there any **questions?**

Senator **MARTIN.** Mr. Chairman, **I** would like a little further explanation as to the statement where you indicate that if we reduce the debt at **the** rate of \$10,000,000,000 per year, there would be great deflation and unemployment.

What amount, in your opinion, **could be** reduced from the public debt per year without danger of **deflation?**

Dr. **Roos.** That is a figure which I have already given by implication. You can calculate it **by** summing of the figures (1) to (5). This sum is 2,800,000,000 for 1948, **sir**. That would **be** the outside figure. Anything faster rate of debt retirement than that would create unemployment.

The CHAIRMAN. It is a rather interesting coincidence, **and I** think a coincidence only, that **the** Senate viewpoint is that we ought to retire not less than **\$2,600,000,000** a year.

Dr. **Roos.** That is interesting. That rate would **be** right. But of course, the real problem **lies in** the correct forecast of income.

The CHAIRMAN. Do you **agree**, Dr. Roos, that it is impossible in advance to set out a **rigid formula of** debt **retirement?** **I do** not mean that it is impossible, but that it is unwise to set out in advance a rigid debt retirement formula to run over a period of **years?**

Dr. **Roos.** **I** think it is very unwise, because your conditions are going to change from year to year. For example, my organizations would never attempt to forecast incomes much beyond a year and a half. On the other hand we would not hesitate to forecast production for 4 or 5 years, but in the case of income there are many collateral factors that can cause inflation or deflation; that is, a balance one way or the other could change the ideal amount of debt reduction, throw it, you see.

While these unpredictable factors do not affect production very much, you see, they do affect income materially.

Let me just illustrate what **I** mean **by** that statement.

In our postwar forecasts, which **I** mentioned here, we have the Federal Reserve index at **170**. Now, a little after that forecast of production **was** made, that is about November 1944, we assumed that **wages would be** advanced between 5 and 10 percent, or about 7 **on the average** after the war. On that basis, we forecast the personal incomes on the old series.

You remember, the income series was revised last June. For the old series, we had personal income declining to about \$145,000,000,000 within 6 months after the war ended, and then rising again to around \$150,000,000,000 or thereabouts.

Now, about a year after that forecast was made, the idea was advanced that labor could get substantial wage advances without affecting prices. That was, I believe, early in November of 1945, after the war was over. At that point, 2 days after the President's discussion of this proposition we advised clients that they would have to prepare for substantial inflation lasting 2 to 3 years.

At that point, we raised our forecast of income for 1946 to \$165,000,000,000, which was a very substantial raise. No change was made in our production forecast despite this very substantial change in the income estimate.

The CHAIRMAN. Out of your wide experience, have you ever known of any instances where there were substantial wage increases in competitive industry that did not reflect in higher prices?

Dr. Roos. Not substantial increases, no. There have been moderate ones from time to time which were offset by (1) increased outlays for machinery, better and more efficient machinery; and (2) better selection of workers.

The CHAIRMAN. But wide-scale? Substantial increases? Is there any known experience in history, in a so-called free economy, where that did not reflect in increased prices?

Dr. Roos. No, sir. The timing, though, is important. Remember, in 1937 industry experienced a big wage increase, but it came after there were already excessive inventories, and after we were already deflating bank credit. And the wage increase was offset by declining activity due to excessive inventories in the other industries, and by the elimination of high cost producers and unemployment.

The CHAIRMAN. I notice your forecast for calendar 1948. Have you made any forecasts for the first 16 months of 1949?

Dr. Roos. Yes; we have several forecasts based on different assumptions with respect to taxes.

The CHAIRMAN. Out of your memory, could you give us something as to the first 6 months of 1949?

Dr. Roos. Yes; if there is no tax reduction, our forecast is that by June of 1949, income will have declined 10 percent from the present level. It would take such a decline to bring about an economic balance again. That would mean personal income of about \$100,000,000,000.

The CHAIRMAN. And with tax reduction?

Dr. Roos. Personal income would be about \$210 to \$212 billion under the Knutsen bill.

The CHAIRMAN. About \$210 to \$212?

Dr. Roos. That is right.

Senator MARTIN. What effect will that have upon the tax return on the present tax basis?

Dr. Roos. Well, the yield would be much higher with a higher income than it is today.

Senator MARTIN. But you are talking about a decrease in income to \$190,000,000,000.

Dr. Roos. That would eliminate the Federal surplus. I mean that the economy itself would correct the attempt to retire debt too rapidly through lower employment and lower employment. The decline in income and employment would be the result of failure to reduce taxes.

The CHAIRMAN. In other words, the income-tax reduction takes that jeopardy out of the system.

Dr. Roos. That is right sir.

Senator GEORGE. What, Doc or, based on your studies, would be the effect of increasing the corporate tax burden, say, \$3,200,000,000?

Dr. Roos. Well, sir, if you refer to chart 2, here you see that an increase in the corporate tax of \$3,200,000,000, which I think was your figure, would have the effect of reducing corporate earnings by a little better than 20 percent. And that, in turn, according to the calculation of the chart, would lower the producers durable equipment expenditures by the same amount, or about 20 percent, that is by about \$3,500,000,000.

There would be a similar adverse effect on plant construction, which is not included in the above calculation, because lower profit would also lower the construction activity. This would be only the net effect, aside from the deflationary effects, which would remain if you only shifted the tax burden and would take in the same amount of revenue income. You would tend, however, to place the burden of adjustment to lower income levels on the durable goods and construction industries. The real problem is not where you put the taxes, but how much they are in relation to income.

Senator MARTIN. Doctor, do you feel that by a proper regulation of debt reduction and taxation we could avoid deflation or inflation?

Dr. Roos. Yes, sir. I am convinced, sir, that industry has reached the point now, where if you give it a reasonable break on fiscal policy it will do a good job of inventory control.

Now, that is quite different than it was years ago. Years ago industry did not have figures necessary for this control. Also it did not know how to use the figures that were available. There was no way of industry knowing what it was doing to create economic unbalances. But I am convinced that today industry could do a pretty good job. And if you added fiscal policy which is designed to stabilize, I believe that the economy will stabilize around an upward trend.

That is, you will avoid the ups and downs of income and unemployment and these dramatic harmful changes in conditions.

Senator MARTIN. Well, for example, to go entirely outside the tax field, we have appealed to industry to police their output, to keep it out of the gray and black markets. But they have not done it.

Dr. Roos. Without appearing to defend industry but merely to enlighten, I would like to suggest something.

Senator MARTIN. I am just asking for information. Because on the sound economy of America depends the position of the world. Outside of two or three little countries, we are the only country that is in anywhere near sound financial position.

Dr. Roos. Yes, sir.

Now, the real problem is this: While there is good national information, local market information is practically lacking. For example, there is no publicly available series on county income or income of a sales region. There is no publicly available information on build-

ing contracts or many other series by local areas by means of which industry can make decisions.

For lack of that information, industry tends to allocate sales, in a tight situation on the basis of past demand. That very method alone can establish these gray markets. Here is how it would work:

A dealer is located in an area that has lost population, and so has no need at all for housing, let us say. And the building-materials suppliers look at the situation only as it was prewar, when the sales were so-and-so. On the basis of this obsolete information they allocate product. Since the companies have no current information, they ship to the dealer on basis of what he used to buy. The dealer in turn has no local market, and so he advertises, for example, so many thousand feet of this, and so much of that, for sale.

A buyer comes along, say, all the way across tile United States and picks up the materials. It is then in the gray markets.

Local market information is a crying need of industry. The Government bureaus do not supply it,

Senator MARTIN. Doctor, do you not believe that if the Government would get out of that field of information, of necessity industry would furnish itself? And such information, in my humble judgment, is very much better than the information that is put out by these bureaus here in Washington.

Dr. Roos. That is true to a certain extent. I am rather on the spot, in speaking here, because my organizations do get out much private information, of a local nature.

Senator MARTIN. I do not want to put the doctor on the spot, but he is giving me, to my mind, some very valuable information, which I cannot only use in this committee but in other committees on which I am serving.

This use of historical production, of the production serving a certain community, is not very sound.

Dr. Roos. It is not very sound, sir; no.

Senator MARTIN. Take, for example, if you may permit, Mr. Chairman, this situation:

In the central west there has been a great improvement in farm machinery which saves labor, a very necessary thing on the farm. But there was no historic formula whatsoever. So those people do not have any steel, and we are trying now to work out some way in which those new plants can be supplied. They are going to employ a good many men, and they are going to help agriculture in the great central west.

That is where we get the greatest amount of our food. So the historical plan, the historical ^{greatest} formula, does not work so well in many cases, we have found.

Dr. Roos. That is correct.

The CHAIRMAN. Doctor, the Secretary of the Treasury has described a \$200,000,000,000 income as representing current levels. Is there any support for that?

Dr. Roos. No, sir. I mean, the current level is about \$209,700,000,000. That is quite a way from \$200,000,000,000.

The CHAIRMAN. What was our last monthly report?

Dr. Roos. \$209,700,000,000 for December.

The CHAIRMAN. 209.7 billion dollars for December. So it is unrealistic to talk about a \$200,000,000,000 current level.

Dr. ROOS. Actually, income is off a little from December, because farm income is down. The decline in farm prices has knocked it down somewhat; but not to the two hundred billion level, sir.

The CHAIRMAN. Now, under the figures that you have given us, on the basis of known current levels, is a \$200,000,000,000 level for the purposes of this committee an an i-inflationary level?

Dr. ROOS. The \$200,000,000,000 corresponds to my forecast if there is no tax reduction for 1948. So, maintaining taxes would operate to make the forecast come out to the low level mentioned by the Secretary of the Treasury.

The CHAIRMAN. Would you describe it as inflationary or deflationary?

Dr. ROOS. It is seriously deflationary.

The CHAIRMAN. It is a badly deflationary theory?

Dr. ROOS. Yes, sir. May I just add this: That over the years we have differed many times with the ~~Committee of the Treasury~~ on the forecasts of income. It might be useful just to put in the record some of those differences.

On January 24, 1946, we forecast personal income for the year at \$165,000,000,000.

The CHAIRMAN. What year was that?

Dr. ROOS. 1946. Now, that was the beginning of the postwar correction. The Treasury estimate had just been raised to \$140,000,000,000. There was a \$25,000,000,000 difference between the estimates.

The CHAIRMAN. And what was the fact?

Dr. ROOS. Personal income was \$165,000,000,000 in 1946. That is the old series, of course, sir. Don't misunderstand me. We can't always forecast so exactly. I probably should not have put that example in the record.

The point I was trying to make is that there was a \$25,000,000,000 difference between the Treasury estimate and ours. Then, in 1947, at about the same time of the year, the Treasury forecast for 1947 was 165 or 166 billion dollars on the old series, whereas, ours was 179 billion on the same series. Now, actually, on the old series the income turned out to be about 181 billion; that is, we were a little bit low. One reason for the lowness of our forecast was the extraordinary advances in agricultural prices near the year end, and another was a secondary wage advance that Mr. Lewis set off in the summer of 1947.

Speaking professionally, I think the Treasury has had no reliable basis for forecasting income. I know what studies they have, and I think they have no sound basis for forecasting income.

The CHAIRMAN. It seems to me it is entirely proper for the Treasury to make a conservative estimate of receipts.

Dr. ROOS. That is correct.

The CHAIRMAN. But the basis on which it makes the estimate certainly ought to coincide a little closer with all of the other informed people on the subject. In other words, in order to reach an estimate of receipts which it wants to be conservative, there ought not to be a distortion of the known facts as to income levels.

The Treasury, as I think Senator George could state much more accurately than I, has been habitually, and in a sense properly, throughout this current administration and during preceding Republican administrations, underestimating revenue. They have almost always done that.

I see nothing wrong with that, if it is within reasonable limits. In fact, I think they should be on the conservative side. But they have been missing it.

Dr. ROOS. A little bit too much.

Senator MARTIN. The executive side would do that, in order to curb the legislative side; which is ordinarily the greatest spender of

the CHAIRMAN. That is right.

Senator MARTIN. This is the first time that I have ever been on the legislative side. I have always been on the other side. And I sympathize very much with the Department if they have in mind to keep down expenditures. Because it is awfully easy to vote for an appropriation particularly when your constituents are interested. It is our form of government.

The CHAIRMAN. Due to a number of factors, Doctor, I doubt very much whether the tax reduction as it finally goes through Congress will hit the full-scale reduction in dollars of the Knutson bill. We have had a lot of things to think about. We not only have to think of fiscal policy for June 1949, but we also must think as far as we can beyond that.

We have some sentiment in the Senate that because of the tender situation of our economy, we should take rather substantial discounts on estimates or receipts; that we ought to be very conservative in our estimates of expenditure reductions; and when you give all of those factors their weight, it may lead you to a figure which would be less than the Knutson figure.

I think most everyone will agree that the Knutson reduction would be possible, if you were only figuring on one fiscal year; to wit, 1949. But in view of all of these other factors that have to be thought of, I repeat that the reduction will probably be somewhat less.

If I had to make a personal estimate, I would say it would be perhaps somewhere between 4½ and 5 billion dollars.

What I am getting at is: Could we relate our figures in that range proportionately to the figure which you have used, to the Knutson figure, for the purpose of estimating effects here?

Dr. ROOS. Well, sir, we can't have as wide a range as that in our own work as the two forecasts presented. We have to base our forecasts on what we think is most likely, in view of the various conditions.

It so happens that our forecasts to our clients have assumed a 4.8 billion cut in taxes.

The CHAIRMAN. Pardon me

Dr. ROOS. It so happens that our business forecasts, our advices to clients, have assumed a 4.8 billion dollar cut.

The CHAIRMAN. Have you, in addition to your other talents, any telepathic powers?

Dr. ROOS. No; it is what you might call an intelligent guess that the cut might be between 4 and 5, and a splitting of the difference, and a rounding of the fraction. That is all it amounts to.

Now, under that kind of a pattern, a 4.8 billion dollar tax cut, the personal income would average around 205 to 207 billion dollars.

That forecast could be upset in one way: If the country had a general round of wage increases of say, as much as 10 percent; which isn't exactly unlikely. That would be an increase greater than we are assuming. We are assuming 8 percent over the October 1947 level. If

it happened to be 10 percent, the income figure would go above \$210,000,000,000, and we would raise our forecast if that wage pattern were set in the next month or two.

The CHAIRMAN. Does your forecast involve the assumption that there is going to be any important recession within the next 18 months?

Dr. ROOS. There will be an adjustment downward in producers' durable equipment, because business is becoming more competitive and the rate of profit is declining.

If there is an attempt to retire debt even at the rate implied by the 4.8 billion dollar tax cut, then profits will go down. There is no other way you can forecast that portion of the economy. And that decline in profits will turn down your producers' durable equipment.

For 3 years already we have had that forecast as a likelihood for late '48 and early '49. This has been the timing that seemed most probable. The first two years and a half after the way would quite obviously be years in which business could not be competitive. The shortages would be so great and the equipment expenditures would be so high, thereby generating current purchasing power unmatched by consumers' goods, that competition in industry would not be possible. It had seemed to us, several years ago even, that it would take 2 to 3 years to overcome the shortages and work off the hearing-deferred demands; and, having to present a longer-term pattern of production, we suggested that a correction would occur in late '48 and early '49. But it will be a very minor correction, provided the fiscal policy—

The CHAIRMAN. I was going to ask you: Do you see any drastic recession?

Dr. ROOS. Oh, no, sir. We are talking about a Federal Reserve index, now at about 190, stabilizing around 175; that is, 175 percent of the 1935-39 average level. The net effect of this stabilization at the 175 level on employment would be that unemployment would be increased by amount a million persons.

The CHAIRMAN. By about a million over the next 18 months?

Dr. ROOS. Yes, sir; over the next 18 months?

The CHAIRMAN. Now, is that on the assumption of a tax reduction?

Dr. ROOS. Yes; of 4.8 billion.

The CHAIRMAN. And if there were no tax reduction at all?

Dr. ROOS. Unemployment would increase by about 4,000,000.

The CHAIRMAN. You would estimate 4,000,000?

Dr. ROOS. About 4,000,000.

Senator MARTIN. That increase of a million unemployed would be above the normal unemployment?

Dr. ROOS. Normal is about $2\frac{1}{4}$ or $2\frac{1}{2}$ million.

Senator MARTIN. That would be above normal, then.

Dr. ROOS. I wouldn't call it normal. The $2\frac{1}{4}$ to $2\frac{1}{2}$ million represents rather the fractional unemployment that has to exist. If a fellow wants to move from New York to California, he enters the unemployed rolls while making the shift.

Senator MARTIN. You cannot help that. There is what we have always termed a "normal" of something over 2,000,000.

Dr. ROOS. That is right.

Senator MARTIN. Then you would have a million above that.

Dr. ROOS. That is right, sir.

I am not so sure that **an** additional million unemployed would be **a bad thing** for the economy, even though it may sound **heartless**.

Senator **MARTIN**. No; it does not at all. That gets into **the American competitive** idea.

Dr. **Roos**. Here is why I make the statement, **sir**. You have today about **a** million more than the normal number of males under **10** years of **age** employed. Kids in the plants. Another **680,000** "bobby-soxers" more than normal **are** in the labor force. Thus a sizable **portion** of **the** national youth that ordinarily would be in school is in the labor force instead. And **the** Nation would be better off if they were in school; maybe not right today, but **5** or **10** years from now the Nation would be better off if those kids had continued their education.

Senator **MARTIN**. They would be worth more to **us** **5** or **10** years from now, as a Nation, if they had gone to school.

Dr. **Roos**. That is right, and to themselves.

The **CHAIRMAN**. Have your estimates of personal income and corporate profits been affected by the recent declines? And if so, to what extent?

Dr. **Roos**. No, sir; not at all. Because actually we forecast the decline. And we did it initially nearly a year ago. That may sound fantastic but it isn't. Because last **May**, or not quite a year ago, **certain** conditions were set up which inevitably meant a price rise in **the fall**, which would carry prices of certain commodities to excesses. We indicated then that rising prices would extend through the year 1947, and that **the** correction would occur early in **1948**. And as early as September **15** we said that the timing of the correction would be between the **1st** of February and the **1st** of April. Prices broke shortly after February **1**. The fact that we got under the line by 2 or 3 days, was, however, accidental again. But we simply mean to point out that conditions were being set up in early 1947 which had to be corrected some time in the early months of **1948**. And the price decline is not an indication of depression or recession. It is merely a correction of a temporary condition of excesses.

In fact, it is overcorrected already as far as the agricultural prices are concerned.

The **CHAIRMAN**. Independent of forecasts, has the money volume of that decline been measured?

Dr. **Roos**. Yes; it represents only a fractional percentage of personal income figures.

The **CHAIRMAN**. What does that amount to?

Dr. **Roos**. It probably represents a decline of about **21½** billion from the December personal income figure.

The **CHAIRMAN**. A part of the recession is in process of correction; to wit, the food end.

Dr. **Roos**. Yes; the food-price recession is already well advanced. Part of it is the food. You see, after all, corn is fundamental in this economy. Its effects on price go through all of the grains to start with, then flour, bread, and so on. In addition to that chain, the effect goes through all the meats, all the fats and oils.

The **CHAIRMAN**. And that hits a lot of industries.

Dr. **Roos**. That is true. In fact, corn is the key to the prices of a great number of commodities in the United States. In making our price forecasts, we watch what is happening in corn very closely.

The **CHAIRMAN**. Starch, alcohol, sugar-

Dr. Roos. Oh, you can go right down the line. Innumerable industries are affected by the price of corn. It is the peg that holds a large proportion of the price level.

The CHAIRMAN. What level of corporate profits do you predict for calendar 1949?

Dr. Roos. Under the tax cut, about 15½ billion dollars after taxes.

The CHAIRMAN. Under a 4.8 billion dollar tax cut, on the Knutson tax cut?

Dr. Roos. That is right; 4.8 billion dollars. Profits would be off from 16.4 billion dollars, I think, in 1947.

The CHAIRMAN. Do the large corporate profits, in your opinion, impair the present levels of production and unemployment?

Dr. Roos. No; I think, rather, that they are responsible for the present high levels of production and employment. After all, corporate profits are the principal source of the purchasing power of the corporations; and the corporate spending is an important part of the economy. You can't get away from that fact.

The CHAIRMAN. Is it not correct to say that the corporations could not supply their capital needs if it were not for the high profits?

Dr. Roos. That is right. Otherwise they would have missed their capital requirements by a wide margin last year. The economy would be in grave trouble this year if they had not had the profits. The expenditures this year, with the commitments already made, are running about \$18,000,000,000 for durable equipment, and another \$6,000,000,000 or so for construction. And this \$24,000,000,000 exceeds the \$15,500,000,000 forecast for corporate profits in 1948. The situation is not quite as bad as it sounds, though, because the depreciation account takes care of a large part of the deficit.

But there is still a gap. There is no question but what the companies need additional money, and they need it rather quickly.

The CHAIRMAN. Did not our abolition of excess-profits taxes in 1945 help to put the corporations in position where they could finance their capital requirements?

Dr. Roos. Well, if you had not done that, personal income arising from the production of durable equipment alone would have been about \$8,000,000,000 less.

The CHAIRMAN. That much?

Dr. Roos. That much less if you had not taken off the excess-profits taxes. That rate of durable equipment output represents two million and a half jobs, incidentally.

The CHAIRMAN. Senator Butler?

Senator BUTLER. The recent decline in commodities undoubtedly caused cancellation of many orders for equipment, with a heavy variety for future delivery.

Dr. Roos. No, sir. On the contrary, orders increased. While that is extraordinary in many respects, these economic series have a way of being rational. I mean, they do not just happen as the numbers turned up in a dice game. Despite decline in commodity prices the pressure is still on to put in new equipment. Chart II shows the great dearth of new equipment during the war years.

Senator BUTLER. The reason I made the statement, Doctor, was that about the time that was happening, I accidentally met the president of one of the large corporations in the country. He was very definitely worried about his future orders. Should he take delivery?

Dr. Roos. **On equipment?**

Senator **BUTLER**. Yes.

Dr. Roos. He may have been correct. But this comprehensive order series for capital goods published by the **Index Member Institute** went up very sharply on the price break. You see how sharply it rose? **[Indicating.]** About 20 percent.

There is nothing wrong about that segment of business at present, it looks pretty good.

Senator **BUTLER**. And I could not escape the feeling that if that situation was general, we were really headed for something. Your chart certainly looks different.

Dr. Roos. If you talked with anybody in the equipment industries in December, he was talking about a decline in new orders. At that time the trend had been downward for about a year. It is just recently that this index has picked up.

The **CHAIRMAN**. Doctor, were you here during the morning, when we were discussing questions of risk capital, and the relation to that of tax reduction?

Dr. Roos. I was here, sir. I don't know how much I heard, though. Very frankly, I was worried about what I was going to say.

The **CHAIRMAN**. I think it is fair to say that the burden of the testimony of Mr. Hanes was that the dividends that are coming from the corporations are going into savings, but to the extent that those savings are going into investment, they are going into indebtedness investment rather than into equity investment. And the reason they are going into indebtedness investment is because it is relatively a safe form of investment. The reason they are not going into equity investment is because they cannot get the return after the effect of income taxes for the risk which is taken.

How does that square with your own views?

Dr. Roos. In a general way, I agree. I would explain the problem a little differently, though.

Savings today are fairly large, in the neighborhood of 10½ or 11 billion dollars, or about 5 percent of personal incomes. Although the percentage is low total savings are high compared with prewar, even if you allow for the increased price level.

Vile trouble is that the savings are in the hands of different people than in prewar days. People who have savings today generally do not know how to buy equities or common stocks. Savings today are in the hands of people who deposit them in savings accounts principally, or if they don't put them there, they put them in life insurance or real-estate speculation, because they don't know where else to invest.

The **CHAIRMAN**. Or well-known utilities.

Dr. Roos. That is correct, sir.

Now, these institutions, the savings banks and the insurance companies, particularly the life companies, are not allowed to buy common stocks. So the savings necessarily go out as debt.

Now, that is not healthy for the economy. I am glad you raised the question, because this committee ought to be concerned about that trend.

If too large a proportion of business expansion is financed by debt, there is no margin for risk, which margin enables industry to take the chances that it must if the economy is to prosper.

The CHAIRMAN. There is a constant impairment of the value of the equity holder in that company. Because you have a rigid indebtedness there which in a period of trouble has first priority not only as to income but as to the capital itself. Is that not correct?

Dr. Roos. That is correct, sir. That is right.

There is another aspect to that, too. A good part of the savings last year were in tile rural areas.

The CHAIRMAN. May I bounce one further thought against you before I forget it?

Is it not apt to make trouble in our banking structure to have too many bank loans that are dependent upon the continuance of high prosperity of business? For the bank's first concern is to protect itself. And when it commences to call in its loans or to make drastic reductions of them, if you cannot finance yourself with equity capital then, obviously the economy is in a very bad way. Is that correct?

Dr. Roos. That is correct. If this trend should continue, there would be eventually set up a condition which would impair bank loans all across the board. The bankers then, willy-nilly, would be in the equity business through foreclosures.

During the depression of the 1930's New York banks owned companies outright, I know of large banks that owned really important companies and had to operate them, had to furnish the management for them.

The CHAIRMAN. One of our highly praised public officials, as I recall it, appeared before the House Ways and Means Committee. He found no fault with our present progressive income tax rates, on tile ground that the higher they are, the more it makes a man work to make a living, and therefore we should not disturb that incentive. And that was seriously proposed.

Dr. Roos. I think he must have been dreaming.

The CHAIRMAN. Of course, the logical extreme is to give him nothing and get the maximum amount of work out of him. That was so asinine that I will not ask you to comment upon it.

Senator MARTIN. You make a very interesting statement here, that the economy of the United States is in excellent health except for the present economic and fiscal policies; and then you state that the correction of much of those credit and fiscal policies is in the hands of this committee.

Do you feel that a tax reduction now of 4.8 billion dollars would partially correct the present fiscal and credit policies of the United

Dr. Roos. It would correct the fiscal policies, sir.

Senator MARTIN. What effect does it have on tile credit policies?

Dr. Roos. I am inclined to believe the bankers are getting a little worried now that maybe they have gone a little too far in credit restriction. I am sure they have. But those kinds of things finally get corrected when you talk about them. And I think the important thing today is the fiscal policy, which is directly in the hands of this committee. That is what I meant.

Senator MARTIN. Doctor, is not the relationship of what we call loans in banks much lower now with respect to the cash position of banks and the amount of Government securities that the bank holds? Is it not much lower now than ordinarily?

Dr. Roos. Yes, decidedly much lower. Because the banks have so many more Government bonds in their portfolios. That situation, incidentally, creates a rather interesting problem.

At the present time when the Federal Reserve Board tries to tighten credit conditions, the banks sell Government bonds. If the Federal Reserve doesn't buy them, the Treasury gets concerned about it. And the two are at each other very quickly.

Now if the Federal Reserve buys all the offerings, then the reserves themselves are increased in the process, and what is a tight credit situation becomes an easy one.

Senator MARTIN. Then you have an inflation.

Dr. Roos. An inflation instead of the deflation the Federal Reserve is trying to achieve. That is what I meant when I said I was not too concerned about Federal Reserve policy. Because it will be self-corrective within a short period of time, if carried much further.

Senator MARTIN. Of course, I do not pretend to be a professional economist, but as I understand it, first you offer securities to the banks and the banks take what they can, and then they go to the Reserve Board. When the reserves fill up it has to come down here, to the Treasury. Then you have an inflationary situation that might become very dangerous.

Dr. Roos. Yes; if you try to tighten the credit too much you may have some real inflation. That is what you are saying, and I agree with you. It is a very dangerous thing to do.

Senator MARTIN. And this is a very bold statement that you are making here relative to the fiscal and the credit policies of the United States: that the economy is in excellent condition, except for that.

Dr. Roos. Surely. I meant exactly what I said.

Senator MARTIN. And that is what I was trying to get at: What effect this tax reduction will have.

I might interject this, Mr. Chairman: When I came down here, I felt that all of the money should go on the retirement of the public debt. I have changed my opinion on that. We have gotten into the condition now where we have to have a more or less planned control of it. I hate to see that. I hate to see it so big that that is what is necessary.

But that I am getting at is whether or not this proposed, we will say, 4.8 reduction will also aid the credit situation as well as the fiscal situation.

Dr. Roos. Yes; it will very definitely, sir.

The **CHAIRMAN.** As I understand it, it aids the credit situation, because by limiting the retirement of the debt you do not contract the credit in the banks. Is that correct?

Dr. Roos. That is right.

The CHAIRMAN. Are there any further questions?

We are very indebted to you for coming and giving us this very instructive talk.

We will recess until 10 o'clock tomorrow morning. And during the morning we will hear a series of Senators on various amendments which they have offered.

I do not know whether we will have an afternoon session tomorrow, but we will try to avoid it.

(Whereupon, at 3:25 p. m., an adjournment was taken, to reconvene at 10 a. m., Wednesday, March 3, 1948.)

REDUCTION OF INDIVIDUAL INCOME TAXES

WEDNE DAY, MARCH 3, 1948

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

The committee met at 10 a. m., pursuant to adjournment, in room 312 of the Senate Office Building, Senator Eugene D. Millikin, chairman of the committee, presiding.

Present: Senators Millikin (chairman of the committee), Taft, Butler, Hawkes, Martin, George, Barkley, Connally, and Lucas.

The CHAIRMAN. The hearing will come to order.

The committee has the pleasure this morning of hearing from Senator O'Mahoney.

Senator, will you proceed in your own way.

STATEMENT OF HON. JOSEPH C. O'MAHONEY, A UNITED STATES SENATOR FROM THE STATE OF WYOMING

Senator O'MAHONEY. Mr. Chairman, my desire is to say to the committee that, in my opinion, this tax bill which is before you will be judged historically because of the effect which it will have upon the system of private profit.

I appear here today urging this excess-profits tax, because I believe that only by such an amendment, and some others which might be suggested, will it be possible to prevent most serious danger to the system. I think everybody realizes today that the great danger to freedom in the world arises from statism, and I think I can show that a failure now upon the part of Congress to proceed as rapidly as possible to reduce the national debt exposes the United States to all the dangers of totalitarianism which have appeared in other countries.

I invite the attention of the members of the committee to the chart which is on the easel, copies of which have been distributed to the members. The significance of the chart is this: It shows that at about 1942, when we were in the midst of the war, the Federal debt for the first time in history exceeded the national income.

Senator O'MAHONEY. Throughout the history of the United States there was no period prior to World War II when the income of the people was less than the national debt. If the Senators will examine the chart for the year 1940, they will see that the Federal debt in that year was less than \$50,000,000,000; and yet during the whole period from 1936 on to 1940, economists and financiers and Members of the Congress were shaking their heads in grave despair about the magnitude of the national debt. They were saying that if we continue to pile up debt, nobody could tell what would happen to our system; but

we became involved in the war and as a result we were obliged to permit that debt to be increased fourfold.

If we apply our surplus upon the reduction of that debt, we invite disaster from two points. We face disaster if the national income should fall while the debt remains at this pinnacle.

Yet the national income is in danger of falling. The studies of the Joint Committee on the Economic Report amply demonstrate that in the lower income brackets, our people are now finding it exceedingly difficult to make their income cover the cost of living.

The CHAIRMAN. Would it follow, from what the Senator has said, then we must handle the debt in harmony with the prevention of the falling national income?

Senator O'MAHONEY. I think that this is part of the story of inflation. If we can keep that national income up—and the Senators will observe it is now in excess of \$200,000,000,000—then it will be a com-

paratively simple matter for us to continue to pay off the debt. But if we allow the national income to fall, their disaster confronts us."

This is exactly what happened during the Hoover administration. When the crash came in 1929, Federal receipts and national income both took a nosedive; and then for the first time in this recent period, we began deficit financing. The receipts of the Federal Government during the last 2 years of the Hoover administration were not sufficient to cover the cost of Government; and at the same time, because we had unemployment, the national income fell. The result was that our national debt began to go up again.

Senator CONNALLY. Might I interrupt you there and ask you a question about national income?

Senator O'MAHONEY. Surely.

Senator CONNALLY. A rise in national income, or decline, for that matter, does not always represent any great change in the wealth of the country; does it?

National income, as we compute it, is based on interchange of goods and trading around, and swapping about, and you have not got any more actual wealth than you had when you started.

Senator O'MAHONEY. I would say that national income increases primarily because people are busy, are working, and are producing. Now, the fact of the matter is that we are producing more in the United States at this time than at any time in history.

Senator CONNALLY. I do not doubt that.

Senator O'MAHONEY. Every branch of the economy is well off. People are making more money than they ever did before. The corporations are certainly making more profits than they ever did before. Nevertheless, instead of undertaking to pay off this national debt, we are undertaking to cut the Federal receipts at a time and in a manner which will endanger the national economy.

Senator TAFT. Might I ask you how much you think we ought to pay on this debt in a year?

Senator O'MAHONEY. I think we ought to pay just as much as we

Senator TAFT. How much would that be?

Senator O'MAHONEY. The payment must depend upon the amount of surplus.

Senator TAFT. That is what we are deciding, how much the surplus would be. How much do we want to pay off on this debt? That is the main question.

Senator O'MAHONEY. The estimates of some economists, as I recall them, have been that the surplus on the 30th of June will be about \$7,000,000,000. I think it would be preferable to pay it all on the national debt.

Senator TAFT. Would you do that regularly, and keep the taxes up so you can do that every year?

Senator O'MAHONEY. I would like to see it done at least until the national debt is no greater than the national income.

Senator TAFT. Take the \$7,000,000,000; There is about \$3,000,000,000 that we take out of taxes and put into these funds. In other words, we buy those bonds back from the public and put them into Government trust funds. That is about \$10,000,000,000 we take out of purchasing power.

Do you not think the moment this inflationary spiral is checked that to take \$10,000,000,000 out of the purchasing power will be a very dangerous deflationary influence every year? t'?

Senator O'MAHONEY. But inflation is not checked yet.
Senate ART. It is checked. Whether it is stopped, that is a question we do not know.

My joint is: Do you not think to take \$10,000,000,000 out of the purchasing power and taking it away from the people is going to be in normal times a most deflationary element (but will precipitate a depression rather than advance?

Senator O'MAHONEY. I think there is a danger in a situation such as you point out. But my objective would be to reduce the Federal debt which is held by the banks and which thereby becomes the basis for additional currency.

Senator TAPP. That is true, but there are times when you want that basis, well you want the banks to be fairly liberal in their lending if you are on the downgrade.

Senator O'MAHONEY. I am glad you mention that, because I want to point out that this tremendously high public debt in the Federal Government is an evidence and a symptom of the stagnation that we want to avoid.

Senator TAPP. It is an evidence of war and that we spent a lot of money and did not tax enough for it. That is about all it is evidence of, I would think.

Senator O'MAHONEY. The total private debt in 1921 was \$161,000,000,000. That fell because of liquidation, and in 1934 it had been reduced to \$126,500,000,000. At this moment, the private debt in the United States is \$150,000,000,000; that is to say, it is less than it was in 1920, and that is the reason why you can read such an article, as there one in the latest issue of Collier's Weekly, pointing out that the financial houses in Wall Street are laying people off because the transaction in private debt have greatly declined. They have declined so greatly that brokers and investment bankers are not making any money.

Senator TAPP. Do you not think the moment you impose excess-profits taxes it will decline more?

Senator O'MAHONEY. The purpose of this excess-profits tax, Senator Tapp, on a graduated scale, is to stimulate the reduction of prices by those large corporations engaged in interstate commerce, which all the evidence before us now shows are increasing prices.

The joint committee yesterday heard Mr. Fairless tell about the increase in the price of steel, head Mr. Homer of Bethlehem Steel say that Bethlehem is probably going to increase the price of structural steel in the future. Last night, after the hearing was over, I had a telephone call from the representative of a group of ornamental iron manufacturers, who said that there had been another increase of price by the Carnegie Illinois Steel Co. of which no testimony was given to us at all yesterday. The latest reports from the livestock markets indicate that the price of meat is going up again. So, we are in the midst of inflation.

Senator TAPP. I do not think we are in the midst of inflation. I am not satisfied that the thing is not going to permanently level off.

However, supposing it is checked; supposing we find next fall an indication of serious depression, and there is an indication of a lot of slowing up in a lot of industries. Then we are saddled with this excess-profits tax and this big reduction of debt at a time when we do not want to deflate any more.

Yet, on your theory, we would be deflating every year with this : 10,000,000,000, and we would be saddled with it.

This excess-profits tax will not be paid until 1949. You will not actually take the cash in until then.

It seems to me that the theory you ought to pay the debt off at the rate of seven or eight billion a year, unless it just happens to break that way because of getting more than you expect, is a pretty dangerous theory.

I think you have got to do it gradually.

Senator O'MAHONEY. Do you think it is more dangerous, Senator Taft, than the theory which you apparently hold that we can continue safely to ask the taxpayers of the country to pay an annual interest charge amounting to 4½ or 5 billion dollars a year on the debt?

Senator TAFT. I do think it is much more unsound. I think the existence of a debt is there. It can be dealt with.

The danger in the debt is either increasing it or decreasing it, and either may be very dangerous, and it may be just as dangerous to decrease too fast as to increase it too fast.

Senator O'MAHONEY. Of course, that is a difference of opinion in which you and I take the opposite poles. I believe, to prevent the continued development of big government in the world, it is necessary for the United States and the Congress of the United States to do everything that possibly can be done to stabilize our fiscal policy by reducing this debt so that it will not continue to be the basis for added money supply.

Senator TAFT. May I suggest, as far as that business of a basis for added money supply is concerned, this \$3,000,000,000 which we take out of the budget and put in trust funds is just as deflationary, as far as I can see.

Senator O'MAHONEY. To that extent.

Senator TAFT. If you add 2 or 3 billion more to it every year, I think that is about as much as we can safely undertake.

Senator GEORGE. Senator O'Mahoney, would you not think it would be much better to plan your debt reduction, your revenues, of course, always permitting?

Would you not think it would be better to plan it than just in a haphazard way, say, to apply all of this surplus regardless of how that may affect the general economy?

Senator O'MAHONEY. My point is that under this tax bill you are not planning the reduction of the debt effectively at all, because you are increasing the money supply in the hands of individuals, at a time when everybody knows it is a large money supply as compared with goods and commodities for sale that causes inflation. In other words, we are right now at that point where, if we do not bring inflation under control, we are likely to create unemployment, to destroy markets, thereby to destroy the Federal revenue and national income. That is the danger, as I see it.

Senator GEORGE. If you do not have some source of equity capital with which you can depend for further expansion and upkeep an operation of your business, you are going to increase your unemployment.

Senator O'MAHONEY. I quite agree with you, Senator.

Senator GEORGE. For that reason, is it not fill wiser to plan your debt retirement, assuming you have got some surplus, and also take care of your economy?

Senator O'MAHONEY. From that point of view, it seems to me that the duty of the Congress is to provide incentives for the investment of private capital. We are not doing it by this income-tax reduction bill. We are not doing it by my excess-profits amendment either. I grant you that.

I have advocated during these hearings on inflation that the Congress should establish accelerated depreciation in order to induce capital to go into the building of new plants to produce more goods. I would be quite willing even that the huge enterprises like United States Steel and Bethlehem and General Electric and all the other giants, should have the advantage of accelerated depreciation. But apparently the Congress is not going to do that. The bill which has come before us is a bill which offers only to decrease the taxes upon individual incomes at a time when everything is crying that we should increase production by stimulating the investment of private capital, not only by the big corporations but also by the little ones.

I would like to see tax reform which would encourage little business and local business. You cannot do it under this income-tax reduction bill. The report which was filed by this committee last year, as I recall it, contained a table which showed that the number of persons drawing net incomes of \$10,000 a year was more than 600,000. The number of persons drawing incomes of \$2,000 or less was 26 millions. Now, it is with respect to those 26 millions that we are creating the danger now by not controlling inflation.

With respect to the excess-profits-tax amendment which I have drafted and submitted to the committee, I shall not undertake to describe the technical details of that. I have a prepared description which was drawn up by one of the experts in the Treasury Department, and I shall ask that that be inserted in the record at the conclusion of my remarks.

(The information referred to will be found on p. 169.)

The CHAIRMAN. It will be inserted.

Senator O'MAHONEY. But let me say this: This excess-profits-tax amendment is designed to—

The CHAIRMAN. Senator O'Mahoney, may I interrupt you before you get on to that.

Yesterday, we had an economist here, and I will quote from part of his statement.

Senator O'MAHONEY. Mr. Hanes?

The CHAIRMAN. No; Dr. Roos.

He says:

This means the Federal debt would be retired at this rate; that is, at rate of 2.8 billion dollars for this year without contributing to inflation or for that matter to deflation. A higher rate of debt reduction would be deflationary and might be disastrous. A rate equal to \$10,000,000,000 per year, which would be the starting rate for 1948 without reduction of taxes, would be so deflationary as to cause severe unemployment and a decline in personal income.

I merely wish to point to the argument that there is considerable opinion that you cannot make these massive reductions in debt at the present time without making a credit contraction which is too severe for your economy to stand.

Senator O'MAHONEY. Of course, I recognize the fact that such an opinion is expressed, and I would be the first to acknowledge that too heavy a reduction, the diversion of too large a proportion of our Federal receipts to that purpose, would have a bad effect.

I do not pretend to say precisely what the reduction should be, but do say that until we get the Federal debt down to the same plane as the national income we are playing with disaster. Indeed, we are, in a way, postponing the payment of this debt so that it will have to be taken up by the generation that fought the war.

It must be remembered that the national debt is a mortgage on all the production of the United States for the future until it is paid. That is basic. Now, if we are not going to pay off that mortgage as rapidly as possible, we shall, as I say, be inviting disaster.

The CHAIRMAN. This seems to be obvious. Senator: That debt will have to be paid, if it is paid honestly, out of a healthy economy. Is that true?

Senator O'MAHONEY. That is right.

The CHAIRMAN. Therefore, the rate of reduction of debt may have relationship to the preservation of a healthy economy, and I do not assume for a moment that you would advocate an inflexible rate of reduction which, under the circumstances, might defeat the very objective to which you are devoted.

Senator O'MAHONEY. Certainly not, but let me call the attention of the chairman to this fact: The Federal Reserve Board, through Mr. Eecheles, made certain recommendations with respect to the control of bank credit. Banks, as a whole were opposed to the application of that method of restraining bank credit, but the banks of the United States have undertaken to bring bank credit down by other means. Why? Because they recognize that if private debt is piled on top of this public debt we shall have a situation from which it may be altogether impossible to escape. So they are holding bank credit down.

And I am saying to you, as long as you prevent private debt in the expansion of plant, and the building of things that private individuals want, as long as you prevent that investment by holding the public debt high, you are preventing every thing that are necessary to save the time system of private property.

The CHAIRMAN. I think everyone will agree, Senator, that we should reduce the debt, but it should be reduced in relationship to the economy.

A year ago the Treasury suggested that the surplus should be put into debt retirement. This year the Treasury, I suggest, backed away from that.

The Treasury, in its recent discussions, has indicated that it could be too precipitous in the matter. So I doubt very much whether even the Treasury would now say that the surplus for the time should automatically be put to the reduction of the debt.

Senator O'MAHONEY. Even I am not saying that.

Senator LUCAS. Mr. Chairman, may I interrupt for one question there?

The CHAIRMAN. Surely.

Senator LUCAS. The economist who testified yesterday afternoon testified, as I understood you a moment ago, that \$10,000,000,000 reduction on the national debt would be a dangerous thing because of its deflationary effect?

The CHAIRMAN. That is right.

Senator LUCAS. Supposing we had \$10,000,000 surplus and applied \$2,800,000,000 on the national debt, leaving the \$7,200,000,000, did he give to the committee what he would do with it?

The CHAIRMAN. He said he would use it for tax reduction.

The burden of his testimony was that if you devote all of this surplus to debt reduction, you are bringing on the very conditions which you wish to avoid; that, therefore, tax reduction is in order.

He had accommodated himself and his theories to tax reduction of the magnitude of \$1,800,000,000. When we asked him how he got that figure, he said that was his estimate of probably where we would wind up.

Senator LUCAS. Assuming now that we came along next year and our national income was running about the same as it is now, and that expert testified that we were going to have a \$10,000,000,000 surplus, it would mean we were going to have to come in with another tax bill.

The CHAIRMAN. Is the Senator directing his question to me?

Senator LUCAS. Yes.

The CHAIRMAN. So far as we can see now, I certainly would favor another tax-reduction bill next year if it appears that we have a \$10,000,000,000 surplus and that there is likelihood of a continuance of a surplus of that kind, say, over the next fiscal year.

In other words, as far as I am concerned, since the Senator has asked me, I want tax reduction every time we can make some debt retirement, in the amount that it should be made, and a surplus available for the purpose.

Senator O'MAHONEY. May I say, Mr. Chairman, that that remark prompts me to point out the line of Federal debt on this chart from 1928 to 1930. The facts are that during that period from 1920 to 1930, there were five tax-reduction bills passed, and they were all urged upon the theory that to reduce taxes would increase Federal receipts. As a matter of fact, they did not increase Federal receipts. The line shows that very clearly. When the crash came in 1929, and Federal receipts fell off as a result of it, and national income took that nose dive which is apparent on the chart, then the Federal debt increased again. So, by 1932, we had a national debt in excess of \$20,000,000,000, whereas at the end of World War I, the national debt was \$20,000,000,000.

Now, I submit that we cannot run the risk of living this present terrific national debt at its high level until we know that we have stabilized our system. We know that inflation has not been stopped. Senator Taft just acknowledged that when he said it had been checked. It was checked temporarily perhaps, but prices are once again going up.

If we should have had anything resembling a recession, it seems to me that the outlook is so terribly dangerous that we cannot afford to tinker with it.

The CHAIRMAN. I suggest, Senator, if we are in that danger, the classic remedy, and easily demonstrated remedy as being a sound one, is to restore more purchasing power to the people by tax reduction.

Senator O'MAHONEY. There is too much purchasing power now.

The CHAIRMAN. The Senator was postulating a depression of dangerous degree, and I was suggesting the classic remedy is to restore purchasing power to the people.

Senator O'MAHONEY. Are we going to restore purchasing power by more Federal spending?

The CHAIRMAN. I am in favor of less Federal spending.

Senator O'MAHONEY. Of course you are, but the classical remedy you suggest is Government spending when you do not have private spending. In other words, as I pointed out, when you do not have private spending as evidenced by private debt, then you have a depression into which the Government must come. That was the classic remedy suggested by President Hoover when he suggested his public works program.

The CHAIRMAN. I am in favor of less Government spending and more spending by the people.

Senator O'MAHONEY. That is what I am in favor of, and that is why I am here today urging the Senator and his committee to take this action, because I say the graduated excess-profits tax which is laid before you here is one which will tend to reduce the prices of the things that the people purchase and thereby maintain purchasing power and thereby make it possible to increase production.

The CHAIRMAN. Since the Senator has said he is in complete agreement with me, I assume he will vote for the tax-reduction bill.

Senator O'MAHONEY. I assume on the same basis that the Senator will vote for the excess-profits-tax bill.

Senator LUCAS. May I ask, Senator O'Mahoney, how much money you expect to recapture from the excess-profits tax under this bill?

Senator O'MAHONEY. Let me say to Senator Lucas that the principle of this excess-profits-tax bill is, first, to make it easier on little business and local business. Therefore we have a specific exemption of \$50,000.

Senator LUCAS. I know that.

Senator O'MAHONEY. No profit will be taxed, whatever its percentage with respect to invested capital or sales, or whatever the measure may be, if it is less than \$50,000.

Then in order to make sure that this will not be a burden upon independent enterprise, I have made the excess-profits-tax credit 135 percent of the normal base, and the base is the same base, the same period, which applied in the wartime excess-profits tax.

Then there is a graduated scale of tax: 50 percent for that part of the excess profit which is in excess of 135 percent and not in excess of 140 percent of normal, plus 75 percent of that portion which is in excess of 140 percent and not in excess of 150 percent; and 100 percent of that portion which is in excess of 150 percent of the normal. The purpose of that graduated scale is to encourage the reduction of prices. I would rather see the prices reduced than to see revenue come in.

The Treasury estimated that the revenue from the excess-profits-tax provision which was included in the Dingell bill would be about

\$3,200,000,000, as I recall it. If prices were not reduced, under this excess-profits tax, the revenue would probably be in excess of \$5,000,000,000; but I am confident that the prices would be reduced, and the facts before us are a clear demonstration that prices could be reduced.

I have here a list of the earnings of about 925 manufacturing corporations in 1947 as compared with 1946. This is an advance copy of the statement to be released today by the National City Bank.

This shows, for example, the percent of change in some groups—I will not mention the groups, but here is one group: net earnings after taxes in this group in 1947 were 23 percent more than they were in 1946, and in 1946 that same group of companies—big, interstate companies—were making the largest profits in their history. Here is another group—this has to do with textiles—net income after taxes for this group was 83.7 percent greater in 1947 than it was in 1946.

(The list referred to follows:)

Preliminary summary of manufacturing earnings in 1946 and 1947

(Net income is shown as reported—after depreciation, interest, taxes, and other charge, and reserves, but before dividends. Net worth includes book value of outstanding preferred and common stock and surplus account at beginning of each year)

(In thousands of dollars)

Industrial groups	Number of companies	Net income after taxes			Net worth, Jan. 1		Percentage change	
		1946	1947	Change	1946	1947	1946	1947
Baking.....	15	\$44,254	\$14,912	+1.6	\$228,001	\$241,448	19.7	18.6
Meatpacking.....	13	67,726	3,338	+23.1	685,149	689,361	10.9	12.9
Sugar.....	20	28,847	64,441	.....	239,234	270,489	12.1	21.6
Other food products.....	47	138,006	191,897	+39.0	772,250	870,578	17.9	22.0
Beverages.....	45	161,099	164,503	+1.7	490,414	625,619	33.0	26.3
Tobacco products.....	17	90,701	169,683	+15.4	765,912	797,650	11.3	13.1
Cotton goods.....	35	61,938	113,799	+83.7	245,843	279,842	25.2	40.7
Other textile products.....	55	132,527	181,291	+36.8	577,307	670,408	31.0	35.0
Leather and shoe.....	26	21,033	38,042	+38.3	226,282	245,131	10.6	15.2
Rubber products.....	18	124,952	112,173	-10.2	611,211	692,034	16.2	16.2
Pulp and paper products.....	7	61,831	116,857	+88.5	472,848	548,073	13.1	21.2
Chemical products.....	39	256,485	319,182	+24.4	1,717,713	1,843,879	19.7	17.3
Drugs, soap, etc.....	13	55,200	59,779	+8.1	291,213	331,625	18.7	18.0
Paint and varnish.....	11	19,946	34,059	+70.8	131,169	143,390	15.2	23.5
Petroleum products.....	21	88,775	151,099	+69.1	899,939	.....	.....	.....
Cement, glass, stone products.....	44	76,109	101,906	+33.4	609,857	675,489	12.5	14.2
Iron and steel.....	3	2,971	409,478	+57.7	3,509,694	3,623,323	7.4	11.2
Agricultural implements.....	12	45,551	90,827	+99.4	694,668	731,416	12.4	12.4
Building, heating, plumbing equipment.....	38	32,117	62,985	+96.1	276,740	317,966	11.6	19.8
Electrical equipment and radio.....	39	46,620	131,956	.....	732,732	890,065	6.4	11.3
Machinery.....	84	46,146	93,791	.....	524,091	567,619	8.8	19.0
Office equipment.....	1	25,972	38,979	+50.1	134,059	155,077	10.7	25.0
Other metal products.....	101	67,754	117,311	+73.1	1,111,630	585,727	13.4	21.1
Automobiles and parts.....	55	33,984	197,718	.....	963,877	792,985	5.1	12.1
Railway equipment.....	14	27,569	41,409	+50.0	321,857	343,260	6.7	8.7
Aircraft and parts.....	13	8,319	18,201	.....	124,855	177,177	6.8	14.4
Miscellaneous manufacturing.....	97	104,56	155,621	+48.8	698,700	782,600	11.0	10.0
To all manufacturing.....	960	2,121,578	3,202,164	+50.2	17,105,668	18,744,288	19.8	17.1

Increases or decreases of over 100 percent not computed. Deficit.

The CHAIRMAN. Senator O'Mahoney, might I interrupt you there? Senator O'MAHONEY. Yes.

The CHAIRMAN. When the then Secretary of the Treasury Vinson was before this committee in 1945 in connection with the Revenue Act of 1945, he said:

“I fearly repeat of the excess-profits tax will stimulate production. Today we are starved for new houses, new cars, new radios, and the like. The best defense against the use of our wartime savings to build up prices on these scarce items is to remove the scarcities. Production is the key. If this end the elimination of the repressive influence of the excess-profits tax will make a real lift that job.”

THE CHAIRMAN. Now let us hear from the other side.

Senator O'MAHONEY. Oh, yes. I voted against it at the time because I was in complete disagreement with it. I think, in view of the fact that the representatives of the press are here, I ought to call their attention to this item of increased profits, because this is the one group that I will mention.

Senator LUCAS. Remember they do not vote.

Senator O'MAHONEY. But their editors out in the country, they may vote. I want them to tell their editors that 36 companies engaged in making paper pulp and paper products enjoyed, in 1947, a net income after taxes 88.5 percent greater than their income in 1946. Now tell the business managers of the newspapers who live finding it difficult to get newsprint what the manufacturers of newsprint are making under the present system.

I could go right down the line. Mr. Chairman. This list prepared by the National City Bank illustrates, from a source which can scarcely be accused of being a wild, adical source, that corporate profits have reached the highest level in history.

I have here also the monthly digest of business conditions and probabilities, issued by a New York group of management engineers, the well-known firm of Stevenson, Jordan & Harrison, Inc. This was issued February 16. I want to quote this statement:

The facts are that the average percent of net profits to net worth of all corporations was never above 8.1 percent in the period from 1920 to 1943, and averaged about 4 percent; and of all profitable corporations was no higher than 9.3

And now the average of increase of net income after taxes, which I grant is a different figure, in 1947 as against 1946, is 52.2 percent.

Senator GEORGE. Fifty-two and two-tenths percent. Is that all corporate?

Senator O'MAHONEY. No; of these 925 manufacturers.

Senator GEORGE. Just some of them.

The CHAIRMAN. Senator O'Mahoney, as you see it, what happens to those profits? What is the stream of distribution of them after they are made?

Senator O'MAHONEY. Of course, dividends have been vastly increased. The rate of dividends is much higher than it ever was before. Last year extra dividends and increased dividends were issued.

The CHAIRMAN. Were they not passed into the economy for expenditures?

Senator O'MAHONEY. That is right, increasing the money supply at a time when we are struggling against inflation.

The CHAIRMAN. And for savings, out of which risk-venture capital can be obtained?

Senator O'MAHONEY. The Senator realizes, of course, that in lower-income groups, the people are digging into savings to meet the increased costs.

The CHAIRMAN. That indicates they should have more income.

Senator O'MAHONEY. To me, it indicates prices should be lower, and that is why I have this amendment, sir; because I say to you that when you increase the income without stopping inflation, you invite disaster. Now, reverse that, Mr. Chairman, decrease the prices so that the people can make their present income with their present money. They supply cover the cost of living, and then you are on the sound fiscal road.

The CHAIRMAN. Production, of course, would have relation to that.

Senator O'MAHONEY. Surely, and does the Senator realize that the index of production now stands at a very high point? The last time I saw it, it was about 188.

The CHAIRMAN. I realize that, and I also realize it will probably have to stand at a much higher point.

Senator O'MAHONEY. And the way to do that is not by decreasing individual income taxes at the sacrifice of cutting the national debt. The way to do that is to provide incentive taxation to encourage the investment of private capital.

The CHAIRMAN. Yes. We are entirely in agreement on your very last statement.

Tracing these profits to which you have referred, have not a very considerable portion been plowed back into increased plants?

Senator O'MAHONEY. Yes.

The CHAIRMAN. And that has the effect of increasing production.

Senator O'MAHONEY. Yes.

The CHAIRMAN. And that is highly desirable.

Senator O'MAHONEY. That has been done.

Senator BARKLEY. The dividends distributed to stockholders have not been put back into the plants, as a rule, have they?

Senator O'MAHONEY. I think not.

The CHAIRMAN. I suggest those dividends help to sustain the economy and to the extent that there are savings margin in them, they, too, are available for increased plants and other forms of investment.

Senator O'MAHONEY. Mr. Chairman, I am very grateful to the members of the committee for their indulgence in listening to me for the better part of an hour.

Senator GEORGE. The dividends paid last year amounted to only a little more than \$6,000,000,000, whatever may have been earned on the books for tax purposes; \$6,500,000,000, or somewhere in that neighborhood, which is in excess of the previous year.

Senator O'MAHONEY. May I call the attention of the Senator to the fact that the United States Steel Corp., in its report for 1916, the report to its own stockholders, explaining its present policy, said that it believed that in times of high carrying capacity, the corporation should make the most it could in order to set up reserves for the coming winter. In other words, that paragraph in the report of the United States Steel Corp., to me, was a declaration of their belief that a depression is around the corner and that their increasing prices and increasing profits are for the purpose of preparing for a depression that may come. And I say to you, gentlemen, that the United States and the world cannot stand another depression in the United States.

The CHAIRMAN. Thank you very much, Senator O'Mahoney, we are very glad to have had you with us.

Senator O'MAHONEY. Thank you.

The committee has been very patient.

(Memorandum accompanying the statement is as follows:)

MEMORANDUM IN EXPLANATION OF THE AMENDMENT TO H. R. 4700 PROPOSED BY SENATOR O'MAHONEY

The purpose of this memorandum is to explain the effects of the excess-profits-tax amendment to H. R. 4700 which was introduced today by Senator O'Mahoney.

REAPPLICATION OF AN EXCESS-PROFITS TAX

Under section 122 (a) of the Revenue Act of 1945 the wartime excess-profits tax came to an end and did not apply to any taxable year beginning after December 31, 1945. However, the provisions of subchapter E of chapter 2 of the Internal Revenue Code, relating to the excess-profits tax, were not repealed by the 1945 act. They were merely put in inactive status. Under the proposed amendment the period of inactive status is terminated with respect to taxable years ending after December 31, 1947. Therefore, in reapplying the excess-profits tax it is not necessary to reenact all of the provisions of subchapter E of chapter 2.

SPECIFIC EXEMPTION AND EXCESS-PROFITS CREDIT

As in the case of the wartime excess-profits tax, the tax under the proposed amendment would be imposed upon the "adjusted excess-profits net income." This term means the excess-profits net income minus the specific exemption, the excess-profits credit, and the unused excess-profits credit adjustment (carry-overs and carry-backs). Under the wartime excess-profits tax the specific exemption was \$10,000. Under the amendment section 710 (b) (1) would be amended to increase the specific exemption to \$50,000. The excess-profits credit would be 135 percent of the wartime excess-profits credit. The excess-profits credit is allowed by section 712 of the Internal Revenue Code and the increase in this credit is provided in an amendment to that section. As in the case of the wartime tax, the excess-profits credit may be computed either under the income method or the invested capital method. A taxpayer may elect the method which results in the greater credit.

Under the amendment there would be a graduated rate system. That portion of excess profits which is between 100 percent and 135 percent of the wartime excess-profits credit would not be taxed. That portion of excess profits which is in excess of 135 percent of the wartime credit but not in excess of 140 percent would be taxed at the rate of 50 percent. On the portion between 140 percent and 150 percent of the wartime credit the tax rate would be 75 percent, and on all excess profits in excess of 150 percent of the old wartime credit the new tax would be imposed at the rate of 100 percent.

In order to compute the tax in terms of these percentages of the wartime excess-profits credit, it is necessary to introduce a new concept; that is, "tentative excess-profits net income." This term is defined in an amendment to be made to section 710 to mean the excess-profits net income, minus the new specific exemption of \$50,000 and minus the unused excess-profits credit adjustment which is provided in section 710 (c). The graduated tax rates are applied to the portions of "tentative excess-profits net income" which are in excess of the specified percentages of the wartime credit. The aggregate of the amounts so computed represents the tax that is imposed on "adjusted excess-profits net income."

Since the percentage is in terms of the old wartime credit, it is also necessary to introduce another new technical term, "tentative excess-profits credit," which is the same as the wartime credit. In connection with the desired rate structure this term is necessary to avoid confusion with the new excess-profits credit which is the credit used in arriving at adjusted excess-profits net income. The term "tentative excess-profits credit" is defined in an amendment to section 710. Since it is the same as the wartime credit, it is defined simply as that proportion of the new excess-profits credit which 100 bears to 135.

CARRY-BACKS AND CARRY-FORWARDS

Section 710 (c) (2) is amended so that there will be no carry-back or carry-forward of any unused excess-profits credit from a taxable year in the interval during which the excess-profits tax was not imposed to a taxable year when the tax is imposed. The amendment also provides that an unused excess-profits credit for taxable year subject to the new excess-profits tax shall not be absorbed by a carry-back to a taxable year in the period when the excess-profits tax was not imposed. By adding a new paragraph (5) to section 710 (c) the amendment further prohibits the carry-back of an unused excess-profits credit from a taxable year in the new excess-profits tax period to a taxable year in the old excess-profits tax period.

MINOR TECHNICAL AMENDMENTS

The amendment also embraces certain minor technical amendments to the code which are necessary upon the restoration of the excess-profits tax. The credit for normal tax and surtax purposes formerly provided in section 26 (e) of the Internal Revenue Code, relating to income subject to the excess-profits tax, has been restored. The definitions of "normal tax net income" in section 13 (a) (2), "corporation surtax net income" in section 15 (a) and the credit for dividends received in section 26 (b) have been restored to read as they did immediately prior to the enactment of the Revenue Act of 1945.

EFFECTIVE DATE

The amendment reimposes the excess-profits tax with respect to taxable years ending after December 31, 1947. With respect to taxable years beginning in 1947 and ending in 1948, it provides for a proration of the tax based on the proportion which the number of days in the taxable year after December 31, 1947, bears to the total number of days in such taxable year.

The CHAIRMAN. Our next witness is Senator Lodge.

Senator Lodge, we are glad to see you back in your old stamping ground. We miss you on this committee.

**STATEMENT OF HON. HENRY C. LODGE, JR., A UNITED STATES
SENATOR FROM THE STATE OF MASSACHUSETTS**

Senator LODGE. It is very nice to be back here, Mr. Chairman.

In order to save the time of the committee, I have had a statement prepared that I think is before you now which contains the amendment that I propose, and the part of the existing law to which it is to be offered.

If it is agreeable to you, I will read this, because it will save your time.

The CHAIRMAN. You may proceed.

Senator LODGE. Mr. Chairman and gentlemen of the committee, under the terms of the European recovery bill now pending in the Senate, assistance is to be extended to the nations of Europe, the cost of which will be borne by the American people. This legislation is rightly based on the premise that the people of Europe will do all in their power to help themselves. I assume that this means not only the people of Europe whose total livelihood is in Europe, but those whose assets may be in this country.

I think this was the view taken by the Foreign Relations Committee when it inserted a provision in the ERP bill directing that each recipient nation would make efficient use of and would locate and control whatever assets its nationals might have in the United States. That is one prong of the fork.

But the action which the Foreign Relations Committee took does not meet all the issue involved, and it is for that reason that I offer the amendment to the tax bill which is now before you.

That would be the second prong of the fork.

This amendment is suggested by the fact that at present certain classes of aliens are not taxed on capital gains arising from taxations in this country and certain other classes of aliens are able to make large profits on our stock and commodity markets without paying any Federal income tax. This is, of course, highly discriminatory against American citizens who are required to pay such taxes.

The amendment which I offer simply provides that existing tax laws which apply to Americans shall also apply to nonresident aliens who are physically present in the United States for at period or periods aggregating 90 days or more. Not being a tax expert myself, I sought and obtained the help of the chief of staff of the Joint Committee on Internal Revenue Taxation, Mr. Stam, on this subject. He assures me that this amendment is workable and is also consistent with existing treaty obligations.

Senator CONNALLY. May I ask a question there?

Senator LODGE. Yes, sir.

Senator CONNALLY. In other words, if they are in this country as much as 90 days under your amendment they would pay this tax?

Senator LODGE. That is right. They would be taxed on their capital gains.

Senator CONNALLY. Why should they not be taxed on capital gains whether they spend 3 months here or not?

Senator LODGE. I think the 3-month period was taken as the one that would be most practical.

Senator CONNALLY. Suppose they do not come here at all. If they have property and are making gains, why should they not pay the tax?

Senator LODGE. I think they should, but I think it would be much harder to reach them.

Senator CONNALLY. I was trying to get the facts.

Senator LODGE. I think you are right.

Senator CONNALLY. They can duck out in 90 days. They do not need to stay that long. They might stay 40 or 50 days and still make trades and profits and go back home.

Senator LODGE. I think it is a very good question. Let me say as far as I am concerned, I would be willing to make as stringent a measure as you can and still have it work.

I tried to make it as simple and workable as I could.

I think you undoubtedly could catch more people than this amendment catches if you went at it with a lower term of residence.

Senator GEORGE. Senator Lodge, I do not think anybody would disagree with your objective in trying to get these earnings here taxed.

You say here that you are assured that this amendment is consistent with existing treaty obligations.

Senator LODGE. Yes.

Senator GEORGE. I think we would have to examine that rather carefully because I think the conventions—

Senator LODGE. I am going to deal with that in this statement in a moment, Senator.

Senator **GEORGE**. All right.

Senator **LODGE**. I wanted to say that one does not have to be a tax expert to realize the injustice of requiring the mass of American people of moderate means to bear the burden of European recovery and not require well-to-do Europeans to do their full part as well.

I would now like to make a more detailed discussion of the proposal based on the information which Mr. Stain procured for me.

Under existing law, nonresident aliens are taxed in the following manner:

1. Those having no office or place of business in the United States are taxed only on their income from dividends, rents, salaries, wages, et cetera, at a flat rate of 30 percent, except where such rate has been reduced by treaty. This rule applies where the gross income is \$15,400 or less. If the nonresident alien having no office or place of business in the United States has a gross income of more than \$15,400, he is required to pay the normal and surtax on his income from dividends, rents, annuities, et cetera, arising from sources within the United States, but is not required to pay any tax on capital gains from transactions made in this country. Thus, nonresident aliens having no office or place of business in the United States are not taxed on capital gains arising from transactions in this country.

2. If a nonresident alien is engaged in trade or business in the United States, he is taxable on his income from sources within the United States, including capital gains. However, it is specifically provided in section 211 (b) of the Internal Revenue Code that a nonresident alien is not regarded as engaged in trade or business within the United States if he merely deals through a resident broker, commission agent, or custodian, in commodities or in stocks or securities. There is considerable complaint about nonresident aliens coming to this country and making large profits on our stock and commodity markets without paying any Federal income tax. To permit such a practice to continue is to discriminate against American citizens dealing on the same markets, and who are required to pay come taxes on capital gains to the United States.

This amendment is an effort to remove this discrimination by deeming a nonresident alien individual to be "engaged in trade or business in the United States," if he is physically present in the United States for a period or periods aggregating a total of 90 days or more and if he enters into transactions within the United States during such taxable year. The amendment is not retroactive; it applies only to transactions consummated in the United States in taxable years beginning after December 31, 1947.

As the committee undoubtedly knows better than I, tax conventions or treaties have been concluded with Canada, the United Kingdom, France, and Sweden. I have added language to my amendment that its provision shall not apply in any way which shall be contrary to any treaty obligation of the United States.

Let me say that I have done this solely to save time and argue ... and not because I doubt the competence of the Finance Committee to legislate in the tax field.

The **CHAIRMAN**. Might I interrupt there. Mr. Stain, is there any principle of international law that may not be expressed in treaties, that has any bearing on this?

MR. STAM. Of course, you have got the decision of the Supreme Court that says that any statute, if later than than a treaty, that statute supersedes the treaty. But for international reasons, generally speaking, you keep the treaty from operation of conflicting statutes.

THE CHAIRMAN. I am not talking about our domestic law or treaties. I am asking, Is there any principle of international law that may not be expressed in our treaties or in our domestic laws that might have a bearing on this subject?

MR. STAM. I do not think so.

THE CHAIRMAN. Will you please proceed.

SENATOR LODGE. I was going to say that as a former member of the Finance Committee I gladly give it full jurisdiction over the entire tax question, and as Mr. Stam just said, I do not question the power of Congress under the Constitution to pass whatever statutes it cares to enact regardless of treaty provisions. This is a matter for the committee to ponder.

As my amendment stands, citizens of Canada, the United Kingdom, France, and Sweden would be exempt, but all other nations of the world would be included.

I am advised that in the case of Canada and the United Kingdom, the amount of taxation which the United States is losing in this manner is very small. Also I understand that a new tax convention with France has been negotiated and is now pending in the Foreign Relations Committee.

THE CHAIRMAN. Senator Lodge, may I ask what is the practice of countries other than the United Kingdom, France, Canada, and Sweden with respect to treating our nationals? What do they do to us under similar circumstances?

SENATOR LODGE. I could not give you the answer to that.

SENATOR CONNALLY. That is specified in the treaties you have with them.

THE CHAIRMAN. I mean the nontreaty countries.

SENATOR CONNALLY. He named the treaty countries.

THE CHAIRMAN. I say, outside of those countries, what do they do to us?

SENATOR GEORGE. The chairman was inquiring in regard to nontreaty countries.

SENATOR CONNALLY. Mr. Chairman, I want to observe here one thing. One thing Mr. Stam said I do not quite agree with.

He said the Supreme Court held that a statute subsequent to a treaty is effective. It is effective on our own citizens and our own people here, but it is still an obligation to the country with whom the treaty is made. That is not wiped out by a statute of the Congress.

A treaty has two aspects: It is a law, so far as our citizens are concerned, but the obligatory part of the treaty to a foreign country cannot be abrogated by a statute.

I just wanted to observe my own view on that thing. Insofar as it is a law, it does operate as such on our own citizens, but as an obligation to a foreign country, it cannot be abrogated unless in conformity with the terms of the treaty.

THE CHAIRMAN. May I suggest, Senator, as far as the international incidents are concerned, they might still be litigated in, let us say, the international courts.

Senator CONNALLY. That is right.

Senator LUCAS. Mr. Chairman, about 2 years ago I was chairman of a Subcommittee on Foreign Relations that went into this subject pretty thoroughly, and made a report on it.

The CHAIRMAN. This same question?

Senator LUCAS. Yes.

The CHAIRMAN. Senator Lodge, have those transactions been of considerable magnitude?

Senator LODGE. The last figures we have are for 2 years ago. Is that right, Mr. Starn?

Mr. STARN. Right.

Senator LODGE. And almost \$4,000,000. Is that right?

Mr. STARN. \$3,000,000.

Senator CONNALLY. In tax or business?

Senator LODGE. Amount of revenue lost.

I am not advocating this as a revenue matter. I am advocating it as a matter of morale and justice.

The CHAIRMAN. Mr. Starn, while you were out, we were making inquiry as to what is the practice of nontreaty countries in the treatment of American citizens under similar circumstances.

Mr. STARN. The difficulty with the whole problem of capital gains has generally been that many countries do not levy any tax on capital gains. So they do not have this problem like we have over here. They just do not tax capital gains.

That has been one of the problems that made this question rather difficult.

The CHAIRMAN. Then our citizens would not be hurt in those countries, as far as capital gains are concerned?

Mr. STARN. That is right.

Senator GEORGE. And our conventions, notably with Canada, Great Britain, and so forth, the ones we have concluded, have generally a reciprocal pattern. They not having taxed capital gains in the conventions, we agreed not to here.

Great Britain, of course, does not impose a capital-gains tax, as such, but if it is a regular trade or business in which the taxpayer is engaged, he may be liable for a tax.

Mr. STARN. I think what happened was this: In the 1936 Revenue Act, prior to that time we had a lot of difficulty in collecting any tax from nonresident aliens, and it was thought, after study, that if we could levy some sort of a gross tax on the income going out of the country to the nonresident alien at a little higher rate, say 30 percent, that we might get more revenue from that source than we would under the existing system in effect at that time, which would try to tax them where we could.

As a result of that, there was some concession made to the nonresident aliens by exempting them from the tax on capital gains. In other words, they paid this 30 percent gross tax on their income from dividends, interest, and rents and so forth, that went out of the country.

That rule was generally applied to nonresident aliens who had a gross income of \$15,000 or less, around that neighborhood. I think it was a little more than \$15,000.

As far as those who had greater amount of income, they had to pay the full normal and surtax rates which might be beyond the 30-

percent rate on their income from sources within the United States, but because of this gross-tax theory that we had, they were still exempted from the capital-gains tax.

That was the system that was adopted in 1936, and when a lot of these tax conventions were entered into, that provision of the 1936 act was incorporated into many of these tax conventions.

That is the way that thing got into the tax conventions. They practically incorporated the 1936 act provisions.

I think it is certainly true that under that system adopted in 1936 we collected a lot more from the nonresident aliens than we did under the old system where we had to go out and see what we could find.

So that is one of the problems which has always confronted the committee.

Senator LUCAS. Mr. Stam, would this amendment violate the treaties we have made

Mr. STAM. The amendment specifically provides it shall not interfere with those treaties, so it could not violate them.

Senator BARKLEY. Let me ask this: Your amendment applies to all aliens regardless of what countries they come from?

Senator LODGE. Who are not citizens of these countries exempted by treaties.

Senator BARKLEY. Let us take a nonresident alien who has an agent in New York, and he invests in the stock market and makes a profit. That is during the period when the nonresident is not in the United States at all, maybe during 1 of the 9 months which he is not required under your amendment to be in this country. And the agency transmits the profits to him, let us say, in Mexico city.

How would you collect this tax?

Assuming that nonresident alien did come here, a month at a time, three different trips, making 90 days, or six trips of 2 weeks, how would you collect it under your amendment?

Senator LODGE. I suppose you would collect it very much the way you do any other tax on capital gains.

Senator BARKLEY. There is no withholding tax applicable to it now, and assuming the profit was sent to the nonresident in Mexico City, it would be there. You could not go down there and get it.

Senator GEORGE. I think, Mr. Stam, are not all these remittances to nonresident aliens impounded until they show a tax clearance?

Mr. STAM. I think at the port they leave the country, they have to show a tax clearance, and at that time the investigation would be made as to whether they had paid the capital-gain tax.

Senator BARKLEY. I am not talking about somebody leaving a port, but somebody who has made a profit during his absence from the United States when it has been sent to him in the country where he lives by his agent, by the broker with whom he is dealing.

The CHAIRMAN. Would not the regulatory powers of the Treasury be sufficient to reach that kind of a transaction?

Mr. STAM. If he was not physically present in the United States, London would not apply, but just using it as an example, suppose he was dealing on the London Stock Exchange in American securities. If he was not present in the United States, he would not be taxable on his capital gain that he made on that American stock on the London exchange.

So they can deal abroad in American securities, and I think that is one reason why it was thought maybe the 90-day rule was a little better protection than no rule at all, because, you see, to some extent, when they do deal on the American exchanges we do collect taxes in the form of stamp taxes, and things like that, which, had they dealt on our own exchanges in the same type of security, we would get no tax from.

So this amendment, as Senator Lodge has pointed out, I think, has attempted to meet the practical problem of people doing business side by side in this country, and one paying no capital gains tax and the other paying a capital gains tax.

Where they transact the business abroad, being a nonresident alien, that income should not be from sources within the United States.

The CHAIRMAN. I am still not clear as far as Senator Barkley's point is concerned. If he does his business here through an agent, in one aspect it would be as though he were here himself. How are you going to keep the funds the agent will pay to him? He will get the funds over there before he pays the tax. Is that not your point, Senator Barkley?

Senator BARKLEY. Yes.

I can see that if the man were here 90 days and transacting business, and during those 90 days, he made a profit and took the money back with him, when he left you could hold him up at the port and make him clear it.

But suppose that money is made during the 9 months he is not in this country and transmitted to him in his own country. The fact he might come over here and stay for 90 days on two or three different trips would not enable you to collect it from him if it has already been sent to the country of his residence.

Mr. STAM. Of course, when a nonresident alien owes taxes, generally speaking, and he is abroad, usually the diplomatic representatives of the United States would contact the other country to see whether or not they could make an arrangement to collect this tax.

It is handled through diplomatic channels in the case of nonresident aliens where the property is abroad. So there would be some effort to proceed through diplomatic channels if we could not collect it in this country.

The CHAIRMAN. Is this bill limited to nonresident aliens who are residents here for 90 days? Is that right?

Senator LODGE. That is right.

Senator BARKLEY. I do not know of anybody who regards the collection of a tax a diplomatic procedure.

The CHAIRMAN. Are there any other questions?

If not, thank you very much, Senator Lodge.

Senator LODGE. Thank you, gentlemen.

The CHAIRMAN. Senator Kem is next.

Senator KEM, we are very glad to have you here.

STATEMENT OF HON. JAMES P. KEM, A UNITED STATES SENATOR FROM THE STATE OF MISSOURI

Senator KEM. Thank you very much, Mr. Chairman, and gentlemen of the committee.

I would like to bring the attention of the committee to two points. The first is this:

A person who earns his living as the result of special training and education is subject to discrimination under the present income tax laws.

Secondly, that a school teacher is now not permitted to deduct as a business expense an essential expense incurred in holding his or her job.

Senator LUCAS. Do you have a copy of your amendment?

Senator KEM. The amendments have been requested from the legislative service and are now being prepared. They are not yet available.

Senator LUCAS. Thank you.

Senator KEM. I have a written statement which has been distributed, and which I should like to have in the record, Mr. Chairman.

The CHAIRMAN. It will be inserted in the record.

(The statement is as follows:)

STATEMENT OF SENATOR JAMES P. KEM BEFORE THE SENATE FINANCE COMMITTEE
MARCH 21, 1938

I should like to invite the attention of the committee to two matters which I believe are worthy of its consideration. The ideas are not original with me. They have been presented to this committee before, and undoubtedly have been considered in previous years by the committee. Whatever the reasons, relief is not accorded under the existing laws. I urge that favorable consideration be given by this committee this year.

My reason for appearing here may be briefly stated. Last fall I spoke on these matters at a meeting of the Lawyers Association of Kansas City. The mail that I received from all over the country indicated a widespread interest in the subjects discussed, and I claim no special competence except in one having some recent first-hand personal experience with the tax burden upon one of the so-called learned professions. I have felt the shoe pinch until it hurt.

The two points I have in mind are: (1) A person who earns his living as the result of special training and education is subject to discrimination in the payment of Federal income taxes. (2) The school teacher is now not being permitted to deduct, as a business expense, the cost of certain essential training required in order to keep a job in the teaching profession.

I. EARNED INCOME IS ENTITLED TO SPECIAL CONSIDERATION

The Federal income tax, as its name indicates, is intended to be a tax on income, not a tax on capital. There are three forms of income: (a) investment returns, (b) capital gain, and (c) earned income.

Adam Smith in his Wealth of Nations, considered that till income should be taxed alike. He asked me the question of determining ability to pay: "How much is your income?" This test, however, is not followed in every case in our income-tax laws. We have gone far afield in affording, for one reason or another, special treatment to various groups or classes. My thesis is that earned income, particularly in the case of a professional man and the skilled worker, is entitled to special consideration.

When a businessman spends a stint of money in order to obtain machinery, equipment, or buildings, necessary in his business, he acquires what is called for tax purposes a capital investment. He may allocate the cost, so much per year, over a number of years, and deduct for Federal income-tax purposes a yearly percentage of the cost. In this manner, he is permitted to deduct from his income, free from income tax, the cost of the necessary equipment to engage in his business. By use of this method of calculating his tax, the businessman does not pay a Federal income tax on that portion of his capital which, theoretically, at least, he uses up year by year. This is referred to as an allowance for depreciation, or depletion. If these deductions were allowed, money would

not readily be invested in enterprises, sometimes financially hazardous, which are essential to industrial development and progress. Production, so necessary for the country's well-being, would be adversely affected.

Now let us examine this situation as it is applied to the skilled laborer and the professional person. Before he can engage in his chosen calling, he is schooled for several years at a considerable cost in order to obtain the specialized knowledge and skill required to engage in his work. Sometimes a license is required, and not infrequently the requirements to qualify for the license include a specified number of years in an approved technical school. This specialized training corresponds to the machinery and equipment of the businessman. It is the skilled man's capital investment. However, a deduction for depreciation or depletion is not allowed as a means of recovering funds that have been invested in acquiring the skill and knowledge so necessary to engage in the work.

The engineer who develops a patentable process or machine cannot charge off against his taxable income the cost of acquiring the knowledge which wits basic to the invention. However, the businessman who purchases that machine or process can, over a period of time, charge off the cost to him of the purchase. The skilled mechanic cannot charge off the cost of obtaining the skill with which he earns his wages, but the cost of those wages to a business can be deducted as a business expense. The physician, the accountant, the teacher, the registered nurse, the machinist, the mechanic, the watchmaker, and the other skilled people find themselves in a similar predicament under the present tax laws.

If the skilled craftsman is to be given the same treatment with respect to income tax as is given to the businessman, he should be permitted to recover through the equivalent of a depreciation charge against taxable income the basic capital he has invested in purchasing an essential item of equipment in order to engage in his work. In the case of the skilled worker the need to use this method is greater than in the case of the businessman, because skill and knowledge, unlike machinery, buildings, and other tangible capital, have no resale value and no salvage value.

The case for special treatment

Several cogent reasons may be assigned for special treatment for tax purposes of incomes of the skilled workers and members of the professions. I shall summarize them.

1. *The professional man and craftsman... is entitled to something in the nature of a depreciation or depletion allowance.*—A lawyer's intellect, a doctor's skill, a nurse's special care, a teacher's instruction, a mechanic's special ability, are not fixed or indestructible capital, capable of producing an income forever. Yet the income they produce is taxed more severely than that from capital because capital is permitted to replenish its loss tax free by dipping into income through depreciation, obsolescence, and depletion.

2. *The professional man and skilled craftsman are put to much incidental expense.*—The individual with earned income has expenses not borne by the individual with investment income. The former must live near his place of employment and maintain a standard of living in keeping with his position. On the other hand, the investor may elect to reside wherever he pleases, thus avoiding the extra expenses required in a particular community, and his standard of living does not necessarily have an effect on the return derived from his investment. Inasmuch as the major portion of these extra expenses borne by the individual with earned income is not deductible for tax purposes, such as going back and forth between home and place of work, it results that earned income is taxed to some extent on a gross basis, while investment income is taxed on a net basis.

3. *Earned income is uncertain.*—Earned income is more uncertain than income derived from capital. If an investor is not too much lured by the possibility of an extravagant return, he may assure himself of a reasonably stable income. On the other hand, the individual with earned income is always confronted with the possibility of illness or accident, either of which may temporarily or permanently suspend his income, thus creating the necessity of savings to protect himself and his family from the possibility of that time when earned income ceases or is substantially reduced. The earned income stops short at the death of the earner.

4. *Capital gains are accorded special treatment.*—As has been said, the present law recognizes the need of special treatment for income derived from certain sources, particularly capital gains. The Revenue Code imposes a tax of not over 25 percent on the gain from the sale or conversion of capital assets held for a period of more than 6 months. There appears to be no reason why earned income arising from personal endeavor should not receive at least as much consideration as capital gains occurring in many cases without effort on the part of the taxpayer.

5. *An incentive should be provided for work and effort.*—Considerations of public policy are involved. Lightening the burden of income derived from personal

earnings would encourage added effort to receive the gain. It should stimulate the personal initiative, the additional hour, and the extra ounce of energy so essential to a highly productive economy.

There is still another benefit to the public from fair treatment to the skilled worker and professional person in this respect. Young men and women would be encouraged to enter training for them, at a time when we hear much of the shortage of doctors, dentists, nurses, and teachers. Also, postgraduate training would be encouraged and the level of competence would be raised.

The arguments against special treatment

Few arguments have been advanced against tax relief for earned income. This may be due to the fact that there has been a surprisingly small amount of discussion of the subject. Three arguments that have been made deserve consideration:

1. *The difficulty of administration.*—It may be admitted that tax relief for earned income presents difficulties of administration. However, this difficulty may be overcome by a settled policy and taxpayer education over a period of time.

2. *Local taxes place a heavier burden on investment income.*—It is contended that a sufficient discrimination in favor of earned income already exists because the local taxes on property place a heavy burden on investment income.

The argument does not appear to be supported by the facts. Indeed, an opposite conclusion seems justified. Figures prepared in 1931 by the Joint Committee on Internal Revenue Taxation show that the individual with little wealth pays an average of 5 percent of his total income, on property taxes, in spite of that fact that 75 percent of his income is earned income. On the other hand, the wealthy individual, with only 16 percent of his income earned, pays in local taxes only 2 percent of his total income. It is apparent then that the earned-income class pays more than its proportionate share of the property tax, and it is eminently fair to give it a reduction in Federal income tax.

3. *All income is on the same moral level.*—Again, it is contended that no distinction between earned and investment income is justified, because such income does not, in either case, vary as to the deserts of the recipient.

Our taxing authorities have never attempted to construct a tax system on a moral basis, realizing its utter impracticability. We can differentiate as to the source of income, but it is hardly practical to deal in moral values affecting the manner of its acquisition.

Form of relief suggested

In 1924 the Federal income-tax laws for the first time recognized that earned income was entitled, for tax purposes, to special treatment. A credit was granted of 25 percent of the normal tax on earned net income, and for the years 1925-31 this credit was extended to apply to both the normal tax and the surtax. During the depression years of 1932 and 1933 the earned-income credit against the tax was eliminated in an effort to increase the Federal revenues. In 1934 earned income was again given preferential treatment. This time a credit was allowed against earned income instead of a credit against the tax, as previously done. This new credit was either 10 percent of the amount of earned net income not in excess of \$14,000, or 10 percent of the entire income, whichever was lower, and applied only to the normal tax. In 1943 the credit allowed earned income was abolished, and the present law provides for no difference in treatment of the various forms of income.

Great Britain now authorizes a credit of one-sixth of earned income, not exceeding a stated amount, approximately \$1,000, as an allowance against income subject to the standard rates.

Canada differentiates between earned income and unearned income by imposing a special tax of 4 percent on unearned income. The first \$1,800 of income from any source is exempted from this special tax.

In Australia all income below \$648 is considered to be earned, and all income over \$10,200 is considered to be unearned. Within these two figures, earned income is favored by imposing two different rates of tax, the lower one applicable to earned income.

In the year 1932 the Joint Committee on Internal Revenue Taxation of the Congress submitted a preliminary report on earned income. It concluded that the principle of allowing a deduction from net income, subject to tax of a certain percentage of the amount of the earned net income, representing a fair allowance for the exhaustion of the earning power of the individual, was fair and sound.

I agree with this conclusion. The differential in favor of earned income should be sufficient (1) to afford an equitable adjustment to the classes involved, and

(2) to serve as an incentive to work and effort. For these purposes, I regard the provision in effect prior to 1943 as wholly inadequate. In my opinion the earned-income credit should be at least 25 percent of the net earned income. The plan decided upon should be sufficient in amount to be worth while, and simple enough to be easily understood.

II. A PROBLEM PECULIAR TO THE SCHOOL TEACHER

I would now like to present a second tax inequality which I believe deserves the attention of this committee.

The practice is now frequent, and it is becoming more so, for school boards to require the teachers to attend summer school every few years to qualify for continued employment or to meet the qualifications for salary increases; and the cases in which the school authorities contribute to the cost of attending summer school are few and far between. The Bureau of Internal Revenue has stated in its rulings that it considers as ordinary and necessary business expenses, and therefore deductible from taxable income, "every necessary item of expense in conducting business, incurred primarily because of and solely in the furtherance of the business engaged in." Yet, in spite of this general rule, in a ruling made back in 1921 and followed consistently ever since, the Bureau of Internal Revenue has held that: "The expenses incurred by school teachers in attending summer school are in the nature of personal expenses incurred in advancing their education and are not deductible in computing net income."

The position taken, in accord with this principle, is that any change will have to result from legislation. If the business organization sends one of its employees to school to learn how to operate a certain machine or to learn how to do a certain job better, it can deduct as a business expense the cost to it of paying for this education of the employee. A physician attending a medical convention or a chemistry professor attending a scientific meeting or convention may deduct the cost as a business expense (*Jack v. Commissioner*, 13 B. T. A. 726; *Silverman v. Commissioner*, 6 B. T. A. 1328). Although the chemistry professor can deduct from his taxable income the cost of attending a convention to gain new knowledge, and incidentally to further his education, if he had spent the same amount of time and money at a summer school of some outstanding university, in order to gain additional knowledge so that he could be a better professor of chemistry, he could not deduct this cost as a business expense, and neither could he depreciate it as a capital investment. This is a matter which has been presented to this committee in previous years. I urge that the committee give it serious attention. We have heard much recently about additional aid for schools so that the teachers can receive an adequate wage. It would help a lot if we had less Federal tax discrimination against school teachers.

Senator KEM. I may say the reason for the delay of the amendment is that the draftsmen are attempting to work out an earned-income credit without affecting the present tables which would make the change very much less complicated than otherwise it would be.

I want to say at the outset that I do not claim any special competence to discuss this matter except this: that I came very recently from the body of the people where I have had some first-hand experience with the tax burden as applied to one of the so-called learned professions.

I have, myself, felt the shoe pinch until it hurt.

I think it is fair to say there is no group of taxpayers in the country in which there is so widespread dissatisfaction with the present tax laws than the group that would be affected by the first proposal I have to make.

Of course, it deals with the income tax.

There are three forms of income affected by the income tax: (1) investment return, (2) capital gains, and (3) earned income.

Adam Smith, of course, would tax all income just as it is earned. He only asked: "How much is your income?"

But, as you gentlemen well know, we have departed widely from that conception, and there are a great many special considerations

given in tile tax laws to certain groups by reason of the character of their income.

I will be very brief, but I want to say a few words on behalf of tile group who earn their income by reason of special training or skill acquired over a period of time.

That applies to all of the professions and to all skilled workers who go through a period of apprenticeship and training.

The essential injustice to which I invite the committee's attention is this: If a businessman invests money in a building, or some machinery, or an oil well, he is entitled to a depreciation, or depletion allowance, running over a period of time; he can charge off each year a portion of the investment that he has made.

Now, a perso who acquires a special skill in some profession or calling is required to go through a period of training that represents a considerable capital investment.

The period over which he can benefit from that is just as limited as the period over which an oil well may produce. It can be calculated with just as great certainty, and yet that individual who, every day is wearing out his brains and his competence, is not entitled to any allowance by way of depreciation or depletion.

I have set out in the memorandum that I have prepared here the reasons that are urged on behalf of an earned-income credit.

I know you gentlemen are all experts in this field, and I am not going to take up your time with going over it in detail.

Of course, the primary consideration is tile fact that the ability of the trained worker is wearing out every day.

Senator CONNALLY. Is not everybody wearing out every day? Is not the laborer and everybody else who is not a highly trained man wearing out his resources also?

Senator KEM. That is right.

I will say to the Senator from Texas that my amendment would give him special consideration. It would give special consideration to everybody who earns his living by the sweat of his or her brow, or by his or her hands.

Senator GAGE. Earned income as distinguished from investment income?

Senator KEM. Exactly; and it would apply to everybody who earns his income.

The reason I emphasize the situation of a person who has a capital investment in a special skill is that the injustice is greater in his case than in the case of a man who does not, and the similarity with tile case of tile businessman's investment in a building or a machine, or in an oil well, is more striking and parallel.

Senator BARKLEY. Does your amendment deal with the question of expenses incurred by a professional man or woman, like teachers, in keeping current preparation for their work like attending a teachers' institute and things like that?

Senator KEM. Yes. I have two amendments. I will say to the Senator from Kentucky my second amendment has to do with that.

My first amendment is earned-income allowance, as the Senator from Georgia has said.

My second is an amendment directed to tile specific injustice now incurred by the members of the teaching profession who, when they

are required to go to a summer school at their own expense are not permitted to charge that as a business expense.

Senator BARKLEY. That would be practically a simple matter to allow that deduction.

Senator KEM. Yes, sir.

Senator BARKLEY. The other amendment, seems to me, is the one that offers some difficulty in establishing a standard by which you will test the depreciation of a man's brain.

Senator KEM. I do not think it is practical to estimate the depreciation directly. I suggest that you allow an earned-income credit to all persons who earn money by personal effort.

The CHAIRMAN. Just as you allow a standard depreciation rate, even though one building may depreciate more rapidly than another?

Senator KEM. I will say to the Senator from Kentucky, previous laws with which you have had to do have made an allowance, just as the laws of Canada and Great Britain and Australia and a great many other countries now make such an allowance.

There is nothing original in my suggestion. It is neither new nor untried nor revolutionary.

Senator BARKLEY. It is to be an arbitrary percentage.

Senator KEM. I am suggesting 25 percent. The last tax law had an allowance of 10 percent.

Senator BARKLEY. I have not read your amendment, but it would have to be an arbitrary percentage.

Senator KEM. Yes; fixed by the Congress in the law.

Senator GORGE. I do not think any one can quarrel with the justice or fairness of your earned-income credit, but we had it, and then we whittled it down to where it did not amount to much, and then decided, for simplification purposes, to get rid of the whole thing.

Senator KEM. I am suggesting the amount of allowance be sufficient to do two things: In the first place, it should be enough to act as an incentive to people to exert themselves.

We hear among these learned professions, and many of you gentlemen belong to them, the statement constantly by able practitioners: "I do not want any more practice than I now have. I do not want to answer any more calls. It is not worth while. The Government would take too much of the additional increment I might make." I respectfully submit that from social and economic standpoints this is very undesirable, and I am suggesting this as something which, in effect, will overcome that.

Now, in the second place, I think the amendment put in the bill, should provide an allowance of sufficient amount to overcome this obvious injustice that a man is incurring who is engaged in a business of this kind, a personal-effort business, as against a man who has a capital gain, or a business that returns him a regular income in normal course.

Senator BARKLEY. Does it apply to all salaried people as well as to business people?

Senator KEM. It applies to everybody. It would apply to everybody who earn their money by daily effort.

Senator CONNALLY. You say that is only applicable to those who earn their income by their own efforts, or words to that effect; is that right?

Senator KEM. Right.

Senator CONNALLY. Suppose, on the other hand, here is an investment of income from a... investment. Does not that represent the efforts of people that accumulated that, the forefathers or ancestors or somebody, just as such as the present income of one of these individual workers?

Senator KEM. Yes. I am not suggesting there is any moral difference in the sources of income, but I am suggesting that there is a sound reason to take into consideration the depreciation or depletion that a personal worker is sustaining every day; not because there is any moral difference in the source.

Senator CONNALLY. I see your point.

Senator KEM. We give the oil operator in the Senator's State a depletion allowance, and fairly so.

We give manufacturers in the State of the Senator from Kentucky those allowances, and they are entirely proper.

I am here saying something on behalf of this very large class who is sustaining a depletion and receiving no credit.

Senator BARKLEY. You can only reach that by an arbitrary figure, I imagine.

Senator KEM. That is correct.

Senator BARKLEY. Because nobody is going to go into an income-tax collector's office and claim his ability has depleted or his mind has depreciated so that he cannot earn any more money.

Senator KEM. I am not going to urge that for a minute.

Senator BARKLEY. As a matter of fact, his capacity is supposed to be represented by his earning capacity, but your theory is, even though a man might continue to earn the same, or more, anticipating the time when he will not do so, he is entitled to an arbitrary credit during his earning period due to the fact he is subject to these human frailties and declines.

Senator KEM. That is right. He is wearing out his brains every day.

Senator GEORGE. It is simply no credit on income in his return.

Senator BARKLEY. Yes.

The CHAIRMAN. Senator Kem, has the Treasury given you any advice as to the cost of your amendment?

Senator KEM. No; I have not consulted Mr. Stain's very able staff in preparation of this. We do have an interesting report made by the Joint Committee on Taxation in 1931, in which, after a careful and scientific examination of the situation, they reported that the principle of allowing a deduction from net income subject to tax of a certain percentage in the amount of earned net income represents a fair allowance for the exhaustion of the earning power of the individual. The committee characterized the principle as fair and sound.

The CHAIRMAN. I am not questioning the principle at all. I agree with you it is fair and sound, and you can make a tremendous argument in favor of it.

I am now directing my question to the cost of it.

Senator KEM. I am sorry I cannot furnish the committee with that information. Perhaps Mr. Stain can.

The CHAIRMAN. Would it be nominal or very substantial?

Mr. STAIN. Senator Kem, your amendment has not been drafted yet?

Senator KEM. It is being prepared in your office.

Mr. STAM. You mean the Senate Legislative Counsel. We have not seen that and, of course, I could not give an estimate.

Senator KEM. My amendment calls for a 25 percent earned-income allowance across the board.

Mr. STAM. Is that a credit against net income? It depends on how it is worked.

Senator KEM. It would be against net income.

I was told this morning that the reason for the delay in drawing the amendment was they were trying to work out a method of applying it without changing the existing tables.

Mr. STAM. You see, under the old law, when you had an earned-income credit that was only allowed for purposes of the normal tax, and therefore the revenue loss would not be anything like as great, as one that would be allowed for both normal and surtax purposes.

As I recall, under the old law, the maximum allowance anybody could get was around \$50, and the Treasury Department presented statistics at one time indicating that as high as 90 percent I think it was higher than that, about 95 percent of the income of people under \$5,000 was earned. So their argument at that time was that people under \$5,000, having that large percentage of earned income, would get about as much relief from a reduction in the rates as they would from distinguishing between earned and unearned income, and that was one of the reasons why, I think, the earned-income provision was abolished in the interest of simplicity.

As far as those people were concerned, 95 percent of their income was earned anyway, and it was felt they could get just as much relief through a reduction in rates. That was the argument they made at that time, as I recall.

The CHAIRMAN. When we get your amendment, we will ask the Treasury for a report of its cost.

I believe I am correct in saying, Senator, that the House Ways and Means Committee has included this subject among its studies.

I do not know what their decision will be, but, if their decision will be favorable, it will be included in what we have referred to as a general revision measure, which would follow this first leisure we are now considering.

Would you have any profound objection if that were the course of the matter rather than attempting to put it into this first bill?

Senator KEM. Of course, I would like to see it done as soon as possible.

Let me say to the chairman that it perhaps is presumptuous for me to appear here at all. As I have said I claim no special competence in this field.

The reason I am here is this: Last fall I made some remarks before a lawyers' association in my State upon this subject. The large amount of mail I received showed me there was a wide public interest in it, and I thought I should invite the committee's attention to the situation.

The CHAIRMAN. I think you made a very fine contribution, and that there would be strong support for something of that kind when the revenues will permit of it.

Senator KEM. My thought is that it is of great importance to keep the body of taxpayers feeling that they are being treated fairly.

I think it wits Colbert **who** said:

The art of taxation Is to **pluck the goose with the least** amount of hissing.

Now, there is a large amount of hissing **on t**he part of people **who** feel they **are** being unjustly discriminated against in connection with **t**he income tax **as** applied to income derived from personal effort.

Senator **CONNALLY**. May I ask a question, **Senator?**

Your second **amendment** allows for **the** deduction of certain items of expense **as a business expense?**

Senator **KEM**. Yes **as a** business expense.

It meets realistically a situation that it is really strange, has not **had** attention before.

I say that without any reflection **on the** committee or **on Congress**.

But here is a teacher **who**, in order to hold his or her **job**, has to go to summer school, and yet **the** taxing authorities say: "**Years** ago we held that was not a business expense.

Now, **t**he situation which is obviously unfair should be corrected **by** legislation.

Senator **GEORGE**. We have had that before us, **Senator Kem**, on more than one occasion.

I thought the present regulation **did** provide for **t**he deduction in case of **a** teacher where **the** teacher, **as** part of **his employment**, is required to take so much training annually.

Mr. Stain, is that correct?

Mr. STAM. I think there is some confusion about the ruling. It has always seemed to me if **the** teacher went out and made **the expenditure** in order to maintain her present position, it ought to be regarded as an ordinary expenditure.

Senator **KEM**. I have **the language** of the ruling here.

Senator **GEORGE**. I said we had it up with **the Treasury** at great length **at** one time, and **the** committee was of **the** opinion that that should be allowable as an ordinary business deduction.

Mr. STAM. If **t**he expense is incurred in order to get into a higher position or **new job**, then it was not.

Senator **GEORGE**. It was not?

Mr. STAM. I think that should be the rule.

Senator **HAWKER**. Is not everybody in the United States trying to get a better **job**, or should they not be?

How in **the** world are you going to decide whether **the** person takes this course in **the** summer school to get a better job or to maintain the one **she** has got?

The CHAIRMAN. The point Senator **George** is making: If it is required in **the** terms of the contract of employment, it should be deductible.

Senator **KEM**. My understanding, Senator, is that it is not. I checked with the **Internal Revenue** bureau last fall when I was about to make the remarks before **the** bar association, and I was told it was not.

They gave me this ruling, **which** they said **had been** in effect since 1921 **and** they felt, in **the Bureau**, that it would be in **the** nature of legislation **for them** to change it.

Senator **GEORGE**. They sometimes do not hesitate to change some others.

Senator **KEM**. I agree with you, Senator.

This is **the** ruling they gave **me** in response to my inquiry:

The **expenses incurred** by schoolteachers **in attending** summer school **are** **in the** nature of personal expenses **incurred** **in** advancing their education **and are not** deductible **in** computing net **income**.

Senator **GEORGE**. I think that is the rule, and **I** think maybe they can **argue** pretty strongly for that, **as** Senator **Hawkes** has suggested.

But where the teacher is obligated, **as** a term of his contract, to **spend** so many days or weeks in some future pursuit of education, **I** thought that **was** a deductible expense.

Senator **KEM**. How would the Senator differentiate this case: A physician attending a medical convention or a chemist attending a scientific meeting, or convention, **may** deduct the cost as a business expense.

That **as** been held in two cases.

Senator **GEORGE**. You are right.

Senator **KE**. Now, if the professor of chemistry can deduct from his taxable income the cost of attending a convention to gain new knowledge, and incidentally to further his professional advancement in his calling, **I** do not understand **why** the teacher who is compelled to attend the summer school, or perhaps does so on his or her own volition, should not be entitled to **the** same credit.

Senator **BARKLEY**. It might **be** they might turn on **the** question whether they are required to do it or whether it is purely voluntary.

Senator **KEM**. Would **the** Senator say the chemistry professor was required to attend his **convention**?

Senator **BA KLEY**. Not without knowing what sort of contract he had with his employer, or something like that.

Senator **KEM**. It would **be** unusual.

Senator **BARKLEY**. We would have to try **justly** to avoid **the** possibility of allowing a deduction for somebody who just wanted to go somewhere and make a trip, and deduct their expenses, though it were a convention, or something where they might receive some advantage.

Senator **KEM**. My recommendation and amendment would **be** directed only to **teachers** who went to school.

The Bureau, itself, has given these chemistry professors **the** opportunity of going on **frolics** of their own all over the country, and they allow that as a business expense. But the teacher that goes to school is not entitled to it. That is what I am complaining about.

Senator **BARKLEY**. **The** rule probably works a greater hardship on the school teachers than any other class, because of their **low** pay, in the first instance.

The **CHAIRMAN**. Surely there should **be** a uniform rule.

Senator **KEM**. There should **be**, and that is the **purpose** of my amendment.

The **CHAIRMAN**. We are very grateful to you for having come.

Senator **LUCAS**. It seems **to** me serious thought ought **to** **be** given and very serious consideration to this in view of what is happening to the school teachers all over the country.

Senator **KEM**. Thank **you**.

The **CHAIRMAN**. Our next witness is Senator Fulbright.

Senator Fulbright, **as** I understand it, you do not have a prepared statement for the committee.

STATEMENT OF **HON. J. WILLIAM FULBRIGHT**, A UNITED STATES
SENATOR FROM THE STATE OF ARKANSAS

Senator **FULBRIGHT**. Not for the committee. I have a statement, but I have not had an opportunity to have it mimeographed.

The amendment is drafted.

The **CHAIRMAN**. Will you submit your formal remarks for the record?

Senator **FULBRIGHT**. I thought I would leave this copy. It is the original copy for the record.

Would like to ask the chairman whether it would be acceptable to read the whole statement or whether I should try to pick out some of the salient points for the sake of time.

The **CHAIRMAN**. Only in the interests of time, I would suggest that you pick out the salient points, and we will insert the formal statement in the record.

(The statement is as follows:)

STATEMENT BY SENATOR J. WILLIAM FULBRIGHT

For 62 years the Federal antimargarine laws have been on the statute books.

I do not think it will serve any purpose to debate whether they were justified at the time they were first passed in 1886. The argument used was that some such laws were needed to safeguard the public from fraud, and to safeguard the health of the public. At that time, margarine was not the nutritious product that it has since become. Even so, the Congress should not have used the taxing powers to lift a margarine and could have dealt with the situation more directly by pure-food laws. But the arguments used in 1880, or in 1902 and 1931 when the Federal margarine laws were amended and strengthened, no longer apply. They are relics of a day when there were few or no pure-food laws, when both margarine and butter were frequently manufactured under unsanitary conditions, and when trade practices were not so enlightened or so subject to public regulation and perusal as they are today.

It is not my purpose to review the whole long history of this controversy, but it will be helpful, I think, if we consider briefly exactly what margarine is, the arguments used to justify its drastic regulation—and it is more drastically regulated than any other food product—and the reasons why these arguments have lost today whatever validity they may once have had.

WHAT IS MARGARINE?

Margarine has been made in Europe since the days of Napoleon III, and in the United States since 1874.

The original product was made largely of beef fat which technically is known as oleo oil, hence the name "oleomargarine."

The name "oleomargarine," indicating the use of oleo oil, is today a misnomer and its use should be discontinued. Ninety-eight percent of the fats and oils used in margarine today are vegetable, but under the archaic law of 1880 the product must still be labeled officially as oleomargarine. The more accurate name is "margarine." It is made almost entirely today of domestic vegetable oils—largely soybeans and cottonseed, with small amounts of peanut and corn oil being used.

An official definition and standard of identity was adopted by the United States Food and Drug Administration in 1941 under the Federal Food, Drug, and Cosmetic Act of 1938. Under it, margarine, has a minimum fat content of 80 percent; the actual average figure for 1947 is slightly more. The standard requires fortified margarine to contain a minimum of 0.000 USP units of vitamin A per pound. But 60 percent of all margarine now is fortified with 15,000 units of vitamin, the content always being shown on the label. Margarine fortification is endorsed by the American Medical Association and leading nutritionists. The only base difference between margarine and butter is that margarine is vegetable fat, butter an animal-fat product. They are equally nutritious. Each offers about 3,300 calories per pound. The amount of vitamin A in butter varies

according to seasonal and other factors; while in margarine it is maximum and uniform the year round. Both products are equally digestible.

Report after report by medical associations and nutritional scientists declares margarine to be a nutritious, high-quality food.

For example, the report on margarine by the New York Academy of Medicine states:

"From a nutritional viewpoint, when it is fortified with vitamin A in the required amount, oleomargarine is the equal of butter, containing the same amounts of protein, fat, carbohydrates, and calories per unit of weight. Moreover, since the minimum vitamin A content of enriched oleomargarine is fixed, and the amount of this vitamin in butter may range from 500 to 20,000 units per pound, enriched oleomargarine is a more dependable source of vitamin A than is butter. Since it is a cheaper product than butter, fortified oleomargarine constitutes a good vehicle for the distribution of vitamin A and fats to low-income groups and should, therefore, be made available to them. Under the standards set by the Food and Drug Administration, oleomargarine is as clean and sanitary a food as butter. The two products are likewise equal in digestibility. Their relative palatability is a matter of individual taste."

A report on margarine by the Food and Nutrition Board of the National Research Council states:

"The present available scientific evidence indicates that when fortified margarine is used in place of butter as a source of fat in a mixed diet, no nutritional differences can be observed. Although important differences can be demonstrated between different fats in special experimental diets, these differences are unimportant when a customary mixed diet is used. The above statement can only be made in respect to fortified margarine, and it should be emphasized that all margarine should be fortified."

Perhaps the most significant study of the relative nutritional qualities of margarine and butter was made by three University of Illinois scientists, the results of which were published in the February Journal of the American Medical Association. In my opinion, this study explodes the contention that butter contains some mysterious and highly beneficial "growth ingredient" not present in margarine.

Three distinguished scientists of the University of Illinois College of Medicine, Drs. Harry Lechenger, George Eisenberg, and Anton J. Carlson, conducted a 2-year study of 217 children in 2 separate orphanages, one group of which had butter in its diet and the other margarine. This study showed no difference in the effects of the fats on growth and health.

I call your attention to the following conclusions of the three scientists:

"Blood studies showed that there were no significant differences between the margarine or butter groups."

"The children in the margarine group experienced a high degree of good health during the study and in comparing their health to those in the butter group it appears to have been much better."

"When infirmary records are compared, it is readily seen that the margarine group fared much better than the butter group. We are not making claims that the margarine group were healthier simply because their diet contained margarine. Other variables are more likely to account for their better health."

In 1886 it was contended that margarine was an unhealthy food and was being sold fraudulently as butter. In 1902, when the original law which imposed a 2-cent tax on all margarine—was amended to reduce the tax on uncolored margarine and place an almost prohibitive impost on the artificially colored yellow product, the argument was again made that consumers must be protected from fraud. In 1931, when the 10-cent tax was extended to all yellow margarine—whether artificially or naturally colored—the contention was made that margarine was a "foreign" product since a great deal of it was being made from imported palm and coconut oil.

I should like to point out here that the "foreign" argument is of no importance today. More than 95 percent of all margarine is now made of domestic ingredients. This argument is as archaic today as the contention that margarine is an unhealthy food.

It is all invalidated by the fact that the antimargarine laws are needed to protect consumers from the possible fraudulent sale of yellow margarine as butter. There were no pure-food laws when Congress passed the antimargarine law in 1886, and both butter and margarine were sold in bulk, or tub form. Now margarine is sold only in certain packages and properly labeled.

Nowadays, the Federal **pure-food** laws and similar pure-food laws in 47 of the 48 States guarantee the **proper** labeling and standard of purity of food products, **including** margarine, thus adequately protecting consumers. There are also, of course, criminal statutes in every State against fraud and misrepresentation.

Of course, no law was ever passed which would prevent lawless men from breaking it. But few risks were ever so well guarded against as the possibility that margarine would be sold fraudulently to any widespread extent if these discriminatory taxes were repealed. If we have any doubts on that score, however, there is no reason why we cannot further strengthen the already extensive labeling and marking requirements to achieve even greater safeguards. I am sure many Members would agree to the general principle that direct legislation of this sort is preferable to the use of the taxing power of the Government to accomplish a similar purpose indirectly.

A dairy organization cites six cases of the fraudulent sale of margarine as butter. This record actually shows there is little danger of fraud. The cases represent the isolated actions of a very few individuals over a period of 20 or 30 years. The amount of margarine involved was infinitesimal by comparison with the amount of the product which was manufactured. The records of judgments under the Federal Food, Drug and Cosmetic Act, published by the Food and Drug Administration, show that from 1930 through 1947 butter was seized for various violations, 2,010 times; margarine only 30 times during this period. In only two cases was margarine seized for contamination, filth, addition of foreign matter, decomposition, or similar reasons. Butter was so seized in 652 cases. Margarine's few seizures under the Food and Drug Administration have been mainly because of slightly less than 80 percent fat content.

During the period mentioned, butter volume was four to five times that of margarine. But the seizures were at a ratio of 100 for butter to 1 for margarine. In this connection, only butter is exempt from certain labeling requirements of the Federal Food, Drug, and Cosmetic Act. The artificial color may be and is added without stating this fact on the label. Special dairy interests that put through the legislation on margarine were able to prevent butter from having to be accurately labeled. Likewise, the label states no grade or other value by which the contents—a pound of butter—may be judged by the consumer. Furthermore, much butter is artificially flavored without so stating on time label.

I think it should be made clear here, so that there may be no concern on the point, that no responsible margarine manufacturer or distributor of margarine—no proponent of repeal of these discriminatory tax laws—is opposed to the labeling and marketing provisions of the pure-food laws. Margarine wants to be known as margarine, labeled as margarine, sold as margarine. I am afraid some spokesmen for the butter interests have conjured up a specter of "fear" on this particular issue that is almost as fraudulent as the thing they say they want to prevent.

Closely allied with the contention that these Federal margarine taxes are necessary to prevent the widespread fraudulent sale of yellow margarine as butter is the claim of the proponents of these laws that butter has some kind of preemptive right to the use of yellow. Indeed, in 1902, when the tax of 10 cents a pound was laid against artificially colored yellow margarine, the claim was freely made that yellow was butter's color and the tax was actually justified as a kind of impost imposed for the use of that color.

Representative Wadsworth of New York, chairman of the House Agriculture Committee, answered this contention when it was first made with a clarity and cogency that seems to me still convincing:

"If that claim is right," he asked "what shade of yellow is it [butter] entitled to. It is only in the months of May and June—and I speak as a practical butter maker myself when I make the assertion—that creamery butter, and that, of course, is the butter of commerce, has a decided yellow color or tint and that color disappears entirely or almost so, when the fall and winter sets in. * * *

"I deny that butter has the copyright, patent right, or any other right to any particular color, whether yellow or otherwise. * * * If coloring oleomargarine helps to perpetrate a fraud, then the coloring of butter is actually a fraud because it makes the consumer believe, and necessarily, that fall or winter or white butter of any season of the year is June butter, which is generally considered the best."

I hope that even those who contend that the antimargarine laws should be continued will not deny that modern margarine is a nutritious and high-quality food—equal in every respect to the butter product.

HOW THE ANTIMARGARINE LAWS PENALIZE MARGARINE

Why then does the Federal Government impose the following taxes and license fees on margarine?

taxes	cents per pound..	Colored modern margarine	Uncolored modern margarine
Manufacturers' license fee.....per year..		\$600	\$600
Wholesalers' license fees.....do.....		480	200
Retailers' license fees.....do.....		48	0

In addition, Federal Regulation No. 9, promulgated and enforced by the Bureau of Internal Revenue, imposes very burdensome restrictions on those engaged in the manufacture and distribution of margarine.

The law imposing the \$600 tax on manufacture of colored margarine has been interpreted to mean that private hospitals, private charitable institutions, public eating places, and others which buy and color margarine must pay the yearly manufacturers' license fee of \$600, plus the 10-cents-per-pound tax.

WHY WERE THESE LAWS ENACTED?

There are, of course, no sound reasons for the imposition of these taxes and license fees on margarine.

Both margarine and butter are colored yellow to meet food habits. We are accustomed to yellow table spreads just as we are used to white milk. We would look with distaste upon green milk—though in every respect except color it might be identical with other milk. Our housewives do not object to white margarine for cooking purposes. They are accustomed to white cooking fats—such as lard. But they do want their margarine yellow for table use. There is no valid reason why their preference should be ignored or thwarted.

Margarine looks like butter. Furthermore, it imitates and is a substitute for butter, but what is wrong with that? If we are to levy a tax on all products which imitate the original, in color and other characteristics, we are going to stifle competition. The very essence of competition is to develop new products which are like the old but which are better and cheaper.

Of course, the supreme irony of this amazing claim of butter to a monopoly on yellow is that the fats and oils used in the manufacture of margarine contain some naturally yellow color. Under Federal regulations, however, these fats and oils must be bleached, a process which adds to the cost of manufacture, in order to make white margarine. Otherwise, the margarine resulting would have to pay the 10 cents a pound Federal tax.

DO THESE LAWS PROTECT THE DAIRY INDUSTRY?

There is little question that the purpose of the 10-cents-a-pound Federal tax on colored margarine and the license fees imposed on wholesalers and retailers, as well as the bulk of State legislation penalizing margarine, is to favor the butter industry and to limit the production and distribution of margarine.

Indeed, a careful study of the congressional debates in 1886, 1902, and 1931 will convince almost anyone that the fundamental reason back of this legislation was not the desire to protect consumers from potential fraud—there were other more direct ways to do that; nor was it that margarine was unhealthy—in which case its sale should have been prohibited; nor was it because margarine, for a time, was manufactured largely from imported oils—higher import duty could have stopped that. The fundamental, underlying reason was a desire to protect the dairy industry in general and the butter industry in particular against competition from margarine.

In 1886, Representative Millard, of New York, a leading proponent of the original bill, told the House: "Either oleomargarine must go or the great dairy industry of the country must be wiped out, utterly destroyed." This argument was repeated over and over. We are still hearing it today.

A report made in 1939 to the Secretary of Agriculture, Barriers to Internal Trade in Farm Products, says:

"Generally, those favoring margarine legislation have been frank to say that their object is to 'protect' the dairy industry. When the Washington tax of 15 cents per pound was carried to the Supreme Court, the sponsors of the act candidly stated that their purpose was to help the butter industry and they made their arguments on that basis."

The Dairy Record, a magazine representing the dairy industry, said in an editorial on June 18, 1941:

"The dairy industry must set as its goal the complete extermination of oleomargarine. It must never rest until the manufacture and sale of oleomargarine have been outlawed in this country."

And Hoard's Dairyman, another well-known spokesman for dairy interests, said, on January 25, 1948: "The tax of 10 cents a pound on oleomargarine colored in semblance of yellow butter is to stop the sale of this product. The tax should be higher. * * * It seems to us the dairy industry has a right to protect its products."

I could cite scores of similar statements which make it very clear that the basic reason for the antimargarine laws was to protect the dairy industry.

Leaving aside consideration of the wisdom or justice of legislation which seeks to protect one domestic product against another or one group of American farmers against another, let us consider whether antimargarine legislation has accomplished its avowed purpose. Has it "protected" the dairy industry?

Let us grant at once—what cannot be doubted for a moment—that antimargarine legislation, both State and Federal, has hurt the margarine industry. It has made margarine more expensive for the manufacturer to make and the consumer to buy; it has made it less attractive to users—especially through the 10-cent tax and other drastic restrictions on yellow margarine; it has curtailed margarine's retail outlets; it has discouraged expansion of the industry. In short, it has limited both the production and distribution of margarine. But, despite this fact, the production of margarine has expanded steadily and the 1947 output of 725,000,000 pounds is the highest on record, exceeding the next highest year, 1940, by 100,000,000 pounds.

But what of the dairy industry, particularly those farmers who earn the major part of their livelihood from the sale of milk for butter making?

In 1901, the year preceding the passage by Congress of the most drastic of the antimargarine laws—the 10-cent tax on yellow margarine—per capita consumption of butter was 10.9 pounds. It has never been that high since.

Following the enactment of the last Federal antimargarine legislation, in 1931, per capita butter consumption fluctuated within narrow limits—dropping from 18.1 in 1932 to 17.8 in 1933, rising briefly to 18.2 in 1934, and then dropping to 17.1 in 1935. With one exception—when it rose to 17.8 in 1939—it continued to drop steadily until 1945.

And then, in 1946, it dropped again—this time to 10.6, the lowest per capita butter consumption in our history. I mention this particularly because the butter lobby has advanced, against all the evidence, the argument that wartime conditions—price control, rationing, and other emergency factors—were largely responsible for declining butter consumption.

The record shows, on the contrary, that total butter production, as well as per capita consumption, has shown a fairly steady decline for many years.

In the 10-year period between 1936 and 1946 total butter production, including both creamery and farm manufacture, declined from 2,131,000,000 pounds to 1,501,000,000 pounds, or approximately 29 percent. At the same time total milk production for all purposes, including butter, increased from 102,410,000,000 pounds in 1936 to 120,276,000,000 pounds in 1946. While there was more milk available for butter manufacture, then, the percentage of this milk made into butter decreased from approximately one-third in 1936 to one-fifth in 1946.

Wartime conditions undoubtedly had some effect on butter production, but they were not controlling, nor were they all disadvantageous to butter, for from June 1, 1943, until October 31, 1945, butter producers received a subsidy of 5 cents a pound.

In 1947, with wartime controls removed, per capita butter consumption is estimated to have been 11.5 pounds. This represented a very moderate increase over 1945 and 1946, but not even the most ardent butter advocate could take much encouragement from it.

It was the third lowest rate since 1890.

It is not margarine that has driven more and more butter out of the market. If this were the reason for declining butter consumption, we should have expected margarine to have occupied that portion of the market vacated by butter. But no such thing has occurred.

Margarine per capita consumption in 1940 was 3.8 pounds higher than it had been in any previous year except 1945. But this represented an increase of only 0.8 pound per capita since 1930. During the same 10-year period butter consumption dropped 5.9 pounds. In other words, the American people, on an average, bought about 6 pounds less butter per person in 1940 than they did in 1930, but they did not fill this gap—and it is a definite nutritional gap—with a corresponding increase in margarine purchases. Only one-seventh of the lost butter consumption was replaced during these 10 years by margarine.

The fact is that butter has been taking itself out of the market. The high cost of producing butter as compared with the more profitable uses of milk; the price at which butter is sold—and for the most part must be sold—to enable butter producers to compete with other purchasers of feed and farm labor and land—these are the factors that, largely of necessity, have given us dollar butter and deprived the butter industry of approximately 30 percent of the market which it had 10 years ago.

Actually, margarine production does not materially affect the price of butter, though, as we have seen, when butter prices are very high, some consumers, who cannot afford butter, turn to margarine. A study, published in 1942 by the Wisconsin College of Agriculture, in the heart of the dairy country, found no relation between margarine and butter prices:

"There is no evidence in the past that oleomargarine has been the important factor in causing low butter prices. In 1932 there were about 11½ pounds of butter consumed for every pound of oleomargarine, and consumers spent \$15 for butter for every dollar spent for oleomargarine. If all the money spent for oleomargarine that year had been spent for butter, the retail price of butter would have been increased 1.7 cents per pound. This would not have solved the dairy farmer's problem."

From the record it seems abundantly clear that antimargarine legislation has failed to aid butter producers. It has simply prevented margarine from occupying the market for table spreads which butter could not fill.

This leads to another question—more important than the first. We have already seen that antimargarine legislation has not aided that dwindling portion of the dairy industry which produces butter. But what of the much larger portion—those dairy farmers who depend mainly upon fluid milk and whole-milk products for their livelihood? Has antimargarine legislation "protected" them?

There are, in the United States, some 24,500,000 dairy cattle owned by approximately 5,000,000 farmers. Of the farmers, 1,178,000—a little more than one-fifth—receive some income from butter manufacture, either on the farm or through sale of milk to creameries. For only half, or approximately 600,000, does butter represent the chief source of income. The others—roughly, 85 percent of all dairy farmers—receive their principal income, or all of it, from the sale of tile products of the cow in fluid-milk form or for manufacture into cheese, dried whole milk, evaporated milk, condensed milk, skim milk, or ice cream.

But butter's importance to dairy farmers generally has been accentuated by certain other factors.

For it was, and still is, the use of butter as a price stabilizer and balance wheel, as it is variously called, which has led many dairy farmers to insist upon special protection for butter against margarine competition. In many parts of the country the price of fluid milk is geared by formula to the price of butter.

If, when depression comes, butter cannot recapture the table-spread market because of the possible encroachment of margarine, then butter prices, it is contended, will fall abnormally and carry down with them the whole dairy price structure.

This argument, of course, does not stand up under examination. In the first place, as we have seen, margarine has never taken over more than a small portion of the table-spread market vacated by butter. But even if margarine, upon the repeal of this discriminatory legislation, took over a much larger share of the table-spread market vacated by butter, or all of it, there is no reason why these formulas cannot be changed, so that the prices of dairy products would be tied to some more stable and profitable product than butter. Indeed, there is every reason why they should be changed if they injure the dairy farmer.

Recently, in the Western Dairy Journal, a prominent dairy farmer, Merritt Nech wrote:

"My interest in the oleomargarine question is primarily selfish. As a person who gets his entire income from a dairy farm, I felt that I have a right to voice my opinion regarding what I think to be the soundest way in which to improve that field of endeavor and to make it more profitable for myself. Butter is our price stabilizer * * * and I object to exactly that. It stabilizes our prices at levels which are generally most unprofitable. Why do we not select a dairy product that will reflect a more advantageous stabilizing effect?"

Even more significant is a report by the Boston Milkshed Pricing Committee, published in September 1947. This committee, composed of a number of outstanding dairy economists, was appointed by Richard D. Applin, acting market administrator, in response to criticisms of the fluid-milk-pricing formula used in the Boston market by representatives of cooperative milk associations. This formula called for a change of 22 cents a hundredweight in the class I milk price for each 5-cent change in the New York wholesale butter price, for each 3-cent change in the New York wholesale price of nonfat dry-milk solids, or for any equivalent combination of the two.

The committee, with Dr. George F. Dow, chairman of the dairy committee of the New England Research Council on Marketing and Food Supply, in charge, worked on their report for 31 months. They studied the milk-pricing situation in general with particular reference, of course, to the Boston market. They recommended that the butter formula for setting class I milk prices in the Boston milkshed be abandoned.

I think you will be interested in some of their reasons for this recommendation:

"For ninety years until 1946 the class I prices in the Federal order for the Boston market have been related roughly to butter prices, over a narrow range of prices. Since June 1, 1946, there has been in the order a full-fledged formula for establishing class I prices. * * * It has been unsatisfactory. * * * Since the end of time war, butter and powder prices have proved to be erratic and unreliable measures of general economic conditions which should be used as a guide to sound fluid milk prices. * * * To cite an example: Consumer buying power was about the same in October 1946 as in March 1947, and the supply of butter moving into trade channels was almost the same in these 2 months; yet the price of butter was 84 cents in October and 64 cents in March. The difference was due apparently to the advance psychological appraisal of demand and supply prospects for butter by the forces that make the wholesale butter market. There is no reason why such errors of judgment should affect fluid milk prices in Boston by 2 cents a quart."

The report, after discussing the advantages and disadvantages of formula price-fixing for fluid milk as opposed to public hearings or other means for setting prices, recommended the establishment of a new formula for the Boston milkshed based, not on butter prices, at all, but on the "composite level of United States wholesale prices, New England department-store sales, and Boston milkshed grain-labor costs."

It seems fairly clear that, today, butter is no longer a desirable price stabilizer for milk products. Indeed, it seems to have become such a liability as a price fixer that the sooner it is abandoned the better for the dairy industry. I think it is fair to conclude that to the extent that antimargarine laws encourage dairy farmers to stick to butter as a price stabilizer—under the mistake belief that butter is "protected" by such laws—they are definitely harmful to the dairy industry.

There remains the contention of time butter lobby that butter is a kind of balance wheel, since its increased production offers the only alternative use for their milk surplus when fluid milk sales decline. This is a key point in the argument of the butter lobby for protective laws against margarine competition, but I think it is at variance with the evidence today.

It may have been partially true once, when the evaporated and condensed milk business were in their infancy, when dried whole milk was just an idea in a scientist's mind, when cheese-making was largely a home industry, and when the ice cream business was a minor outlet for the products of the dairy cow.

But today, the situation has changed.

The following table indicates clearly how these whole milk industries, all of them more profitable alternative users of surplus milk than butter, have grown in recent years:

Utilization of milk in whole-milk dairy products

Product	Amount in pounds		Percent of 1946 Increase
	1930-35	1946	
Fluid milk and cream.....	44,140,000,000	59,927,000,000	35.7
Ice cream.....	3,083,000,000	8,420,000,000	173.11
Cheese.....	6,900,000,000	10,990,000,000	64.2
Evaporated milk.....	4,024,000,000	6,028,000,000	51.5
Condensed milk.....	426,000,000	574,000,000	34.7
Dried whole milk.....	146,000,000	1,448,000,000	992.0
Total.....	8,515,000,000	87,455,000,000	49.8

By contrast, as we have seen, total butter production during this period dropped more than 600,000,000 pounds, or approximately 20 percent.

Moreover, the expanded margarine production which might be expected if antimargarine laws are removed would offer an important outlet for milk products in times of depression as well as prosperity. For skin milk constitutes approximately 15 percent of the constituents of margarine.

Now, of course, the more milk we divert to butter production, the less we have for fluid milk and other whole milk products—such as ice cream and cheese—which, unlike butter, utilize the full nutritional value of the milk solids. In the course of butter manufacture, the rest of the milk is fed to livestock, thrown away, or converted into nonfat dry milk powder. And since butter utilizes little of the nutrients of whole milk besides vitamin A, these nutrients are wasted when not converted for some human use.

W. A. Wentworth, vice president of the Borden Co., pointed out, in an address to the Minnesota Ice Cream Manufacturers Association in December 1947, that if we had attempted to produce enough butter in 1947 to make the per capita consumption of 10 years ago possible, it would have been necessary to divert 13,500,000,000 pounds from fluid and whole milk uses.

He said: "If this 13,500,000,000 pounds were to come from the supply for some other dairy products, it would take more than all of the milk which will be made into whole milk cheeses this year (1947) or it would take 80 percent of the milk which is being made into both ice cream and evaporated milk in 1947."

Any attempt, therefore, in good times or bad, to increase butter production would necessarily be at the expense of these whole milk products and of fluid milk and fluid milk distribution, whole milk industries such as ice cream, cheese, and dried milk, the income of dairy farmers, and the health of our people.

It is difficult to understand how even the butter lobby can make any considerable number of farmers believe that it is ever to their economic interest to "protect" butter production at the inevitable expense of milk production.

For the sale of the dairyman's product as butterfat is, as I have stated, a sale at the lowest price for that product, and the sale of fluid milk is the highest. Other whole milk products, such as cheese, ice cream, etc., fall in between these extremes. The average price paid to farmers for butterfat sold as fluid milk or cream during the 10-year period, 1930-45, was about 74 cents per pound; for milk sold as butterfat about 37 cents. Consider what this meant to the dairy farmers of this country.

This fact was not lost upon all of them, of course, and accounts for the fact that while much more milk was produced in 1947 than a decade ago, much less butter was manufactured.

The statistics graphically tell the story of the decreasing importance of butter and the rise of fluid milk and other byproducts.

In 1946, the dairy farmers' total cash income from the sale of all his dairy products was \$3,716,874,000, of which only \$548,874,000 came from the sale of butterfat and farm butter—exactly 14.7 percent of the total. Just 10 years before, income from butterfat and farm butter had amounted to 29.5 percent of the dairy farmers' total income.

As a result of declining butter production and increasing utilization of milk for fluid use and in whole milk products, butter today, in certain sections of the country, constitutes such a minor factor in the dairy industry as to make the claim of the butter lobby that the industry's continued prosperity depend upon the suppression of margarine an absurdity.

The following table graphically illustrates the extent of the decline in butterfat production and butter manufacture in terms of farmer income:

Year	Income from sale of whole milk as a percentage of total dairy Income	Income from sale of butterfat and farm. butter as a percentage of total dairy Income
Wisconsin	1936 70.0 1941 89.88	21.0 10.2
Minnesota	1941 98.64 1946 23.4	1.36 78.6 72.6
Illinois	1946 68.1 1936 77.8 1941 82.0	31.9 22.2 18.0
Indiana	1940 88.6 1936 71.2 1941 80.2	11.4 28.8 19.8
Michigan	1946 90.2 1936 69.5 1941 77.5	0.8 30.5 22.5
Kansas	1946 87.9 1936 44.0 1941 42.5	12. 56.0 57.5
Ohio	1940 55.9 1941 78.7 1946 87.4	44.1 21.3 12.6
Iowa	1946 93.5 1936 24.4 1941 23.3	6.5 75.0 1.4
Washington	1946 29.3 1936 71.8 1941 77.2	70.7 28.2 22.8
9 North Atlantic States	1946 90.6 1936 90.6 1941 97.9	0.4 3.4 2.1
16 Southern States	1946 98.4 1936 74.2 1941 77.0	1.6 25.8 43.0
11 Western States	1946 85.5 1941 73. 1948 79.7	14.5 26.4 20.3
United States	1940 91.3 1936 70.5 1941 75.8 1946 85.2	8.7 29.5 24.2 14.8

(Data from **Agricultural Statistics**, U. S. Department of **Agriculture**.)

HOW BEST TO "PROTECT" THE DAIRY INDUSTRY

The real interests of the dairy industry—and of the country as a whole—would best be served by expanding fluid milk consumption, at least until we achieve the nutritional goal of 100 quarts more per person per year recommended by the Bureau of Home Economics. This could be done through educational campaigns emphasizing the importance of fluid milk and of other whole milk products in the individual diet; through expanded use of milk in such nutritionally desirable projects as the school-lunch program—which should be extended to every public school in America; and, of course, through wider use of modern milk production techniques and improved marketing methods.

But this could not be done, of course, if any considerable portion of the total milk supply were diverted from fluid and other whole milk products to butter manufacture.

THE ANTIMARGARINE LAWS HURT AMERICAN FARMER

One of the unfortunate aspects of the Federal antimargarine laws is the harm done American farmers who produce the ingredients which go into margarine. These ingredients are the products of farms in 44 of the 48 States. Their sale to the margarine market constitutes an important source of income for over 2,300,000 farmers in every section of the country.

Eighty percent of the constituents of margarine are vegetable fat, 15 percent is skim milk-pasteurized and cultured; the other 5 percent is made up of salt and various other flavoring ingredients.

For the fiscal year 1946-47, according to the Bureau of Internal Revenue, 47.4 percent of the vegetable fat used in margarine was cottonseed oil; 41.5 percent was soybean oil; and 3.1 percent was peanut oil. Corn oil and other vegetable oils account for the remainder.

The total farm value of the cottonseed produced in 1946 was \$246,473,000. This was shared, in part, by 1,600,000 cotton growers who received income from cottonseed oil. The most important market for cottonseed oil in 1946 was shortening. In 1947, it was margarine. During the first 9 months of 1947, margarine used 32.5 percent of the total cottonseed oil refined. In 1946, 222,814,000 pounds of cottonseed oil was used in margarine. During the first 9 months of 1947, 104,484,000 pounds were used in margarine.

It is absurd for certain spokesmen for the dairy interests to continue to repeat that margarine is a "minor" market for the cottonseed farmer. Even if it were true, it would not excuse discriminatory laws against margarine, but the record reveals that it is not true.

The pleas of the Cotton South for the removal of these burdens on the livelihood of its farmers have been heard many times in this Congress. They have gone unheeded, largely, I think, because the cotton farmers were neither so well-organized as the butter farmers, nor so influential politically—due, largely, to the political situation in the South.

But the contest, this time, is not one with the Cotton South. Aside from the increasingly powerful protests of housewives and other consumers from every section of the country, there is another group of American farmers who have a vital interest in the repeal of these one-sided laws. The soybean farmers, too, are deprived of a fair return for their labor by legislation which prevents margarine from competing, like other domestic products, in a free American market.

There are three great soybean-producing areas in this country: the North Central or Corn Belt region—Illinois, Indiana, Ohio, Iowa, and Missouri; the Mississippi Delta—Arkansas, Mississippi, and Louisiana; the Middle Atlantic coast—North Carolina, Virginia, Maryland, and Delaware. These are the principal, but by no means, the only areas in the United States in which soybeans are produced. Thirty States produced soybeans in some quantity in 1946 and so amazing has been the expansion of this crop and the improvement in the varieties used—varieties that are adaptable to a wide range of soil and climatic conditions—that we may expect an even wider geographical distribution of soybean production in the future.

In 1924, total production of soybeans for sale as beans was 4,247,000 bushels; in 1933, 13,509,000 bushels; in 1939, 90,141,000 bushels; in 1946, 196,725,000 bushels, or 41 times as much as in 1924.

The value of soybeans—sold as beans—has increased from \$12,698,000 in 1933 to \$73,052,000 in 1939 to \$517,387,000 in 1946.

Perhaps the most important factor in expanding soybean production was the opening up, in the early 1930's, of profitable markets for soybean oil in the shortening and margarine industries. This was a triumph of long years of research leading to improved processing and refining methods which permitted a greater utilization of the edible properties of the bean.

Significantly, the greatest expansion of the soybean industry has occurred in the North Central region—Illinois, Indiana, Ohio, Iowa, and Missouri, along with Minnesota in the heart of the dairy farming country. Not only does this region produce more soybeans than any other, but it harvests more of that production for sale as beans.

Just how important the soybean industry has become as compared, for example, with the butter industry, to the farmers of the Midwest, is illustrated

in the following table, compiled from Department of Agriculture statistics for 1918.

Cash receipts, with comparison

State	Soybean crop	Percent of all crops	Butter and butterfat	Percent soybean receipts of receipts
	Thousands.		Thousands.	
Illinois.....	\$183,243	31.0	\$20,021	915.0
Iowa.....	82,182	26.4	111,737	73.2
Indiana.....	54,97	23.7	12,645	438.0
Ohio.....	36,9055	14.7	12,254	308.3
Missouri.....	34,240	18.1	22,202	184.6
Minnesota.....	22,172	9.0	76,46151	28.9

REPEAL OF THE ANTIMARGARINE LAWS WOULD BENEFIT OUR COUNTRY

I should prefer, however, to base my argument for freeing an important market for soybean farmers from restrictive laws on another plane than competition. I am not willing, if it can be avoided, to pit one group of American farmers against another. I am for the dairy farmer, the cotton farmer, and the soybean farmer. We should never have discriminated by law against one group of American farmers for the benefit of another.

No; there are other more compelling reasons it seems to me for freeing this highly important market—margarine—from restrictive legislation.

These reasons are concerned with the welfare of the country as a whole—with a healthy economy and a healthy people.

In recent years, despite some improvement in production, we have been plagued with scarcity—scarcity of food, particularly of meats, grains, milk, and fats. This scarcity—which is by no means due entirely to overseas commitments resulting from the war—has been reflected in higher prices, which in turn have led to demands for higher wages.

But there is one domestic crop in which no wartime shortage developed: Babies. Approximately 10,000,000 wartime babies threw the estimates of population out of line. These new Americans must be clothed and housed and fed.

It is scarcity economics to discriminate against any good food products, a product which is needed to meet the nutritive standards demanded by our expanding population.

There is, as we all know, a desperate need abroad for grain for human consumption. At the same time there is, according to the Department of Agriculture, a serious protein deficiency in livestock feeding today.

There is abundant evidence to show that meal from soybeans and cottonseed, if made available in sufficient quantities through the expansion of the vegetable oil markets, would not only offer an efficient means of overcoming this deficiency in the livestock ration but would, also, help free grain for human consumption.

Mr. Ersel Walley, president of the American Soybean Association, points out that soybean oil meal, containing over 40 percent digestible protein, today leaves the processing plant at approximately the same price per pound as is paid for wheat or corn by livestock feeders. Yet a pound of soybean oil meal will replace from 3 to 4 pounds of corn in the livestock ration, discourage the feeding of wheat, and will, therefore, help alleviate both the protein deficiency and the grain shortage.

Cottonseed-oil meal would prove, for all practical purposes, equally efficacious. It compares in price and nutritive qualities with soybean meal.

It is not surprising then, as an Agricultural Department publication, The Deficit in Protein for Livestock (1946), points out, that "How much farmers will buy (of high-protein concentrates) is therefore literally only a question of how much will be available, as it is probable that whatever is produced will be bought and fed."

One argument which has been heard often from tile proponents of these restrictive laws is that soybeans are destructive of the soil and therefore economically wasteful. Little or no support for this argument has ever been offered but, like the tinling radio commercial it seems to depend on repetition alone for its appeal.

Recently the Christian Science Monitor **investigated** the truth of **this** contention. I quote from **the** **Issue** of January 14, 1948:

"Spokesmen for the **butter industry** have made repeated claims that a **substantial increase in the soybean crop**, from which soybean oil, a **prime ingredient** of margarine, **is made**, would be detrimental to soil conservation and adversely affect the general agricultural economy of **the Nation**. It **is** argued that 'soybeans and other fat-producing seed crops are soil-depleting crops.'

"These claims are not substantiated by technicians **in the** Soil Conservation Service of **the Department of Agriculture**. They state: 'On the basis of our experience, if soybeans are grown, even as a clean-tilled crop, with proper **conservation** methods and **practices** to protect the land, they are no worse on the land than any other **clean-tilled** crop such as corn and cotton

"The soybean plant, which **is** a legume, benefits the land by **adding** nitrogen to **tile** soil through **its** roots.

"**Soil conservation**,' Department of Agriculture specialists **say**, 'does not mean **onl** the conservation of topsoil, **but** putting all soil to the use for which **it is** best adapted.'

"* * * Federal technicians charge that dairy farmers are as guilty of **im**-proper utilization of their land as crop farmers. Pasture lands **can be** greatly injured by grazing at wrong seasons or by grazing too much stock per unit of land."

I want to **emphasize** the statement of **Department of Agriculture specialists** regard to soil conservation: They say, what many of us may not have **con**-sidered, that soil conservation **involves** more than **the** saving of topsoil. In this sense, I think we **can** agree, **it** involves the most efficient use of a given acre of land and a given amount of farm labor; **it** involves "putting all soil to the use for which **it is** best adapted."

In 1943, tile Iowa State College—**from** the heart of tile largest **butter-producing** State in the **Nation**—**published** the fact that **1** acre of soybeans will produce as many pounds of vegetable fat as 2 acres devoted to dairying will produce of butter fat. Their report stated also that **1 man-hour** of labor will produce **13.3** pounds of soybean oil compared with only **1.5** pounds of butterfat.

The Iowa State survey concluded by recommending that "restrictions on **the sale of margarine—State excise taxes, license fees, etc.—should** be removed so that **its** consumption may be encouraged."

C. F. Christian, farm marketing specialist at Ohio State University, also studied this problem recently.

"The dairyman," Professor **Christian** revealed, "raises an **acre of** grain, usually corn, and **has** another 2 acres **in** hay or pasture to produce **225** pounds of butter. The acre of corn will take at least **30** hours' work and hay and pasture require more work, and care of **the** cows will involve another **150** hours **in** producing **225** pounds of butter.

"An acre of soybeans can be **grown with** 14 hours of **man** labor and will make about **225** pounds of margarine.

"A pound of butter represents **10** times **the** amount of farm labor and three times the amount of farm land that **is** represented by a pound of margarine."

In conclusion, I should like to emphasize this point: I do not believe there **is** a single **Member of this Congress** who wants to destroy the **butter industry**. I do not believe any of **the** Members who have introduced **bills** for the repeal of the **antimargarine** laws want to hurt the dairy **industry**. It **is** my sincere belief that the repeal of these laws would be to the advantage of all farmers, including dairy **farmers**, and of the American people generally.

Much of **the** argument voiced **in** defense of **the antimargarine** laws **has** been based **on an** unproved assumption that without this **discriminatory** legislation, the dairy industry would be disrupted. There has been no proof submitted **in** this Congress or elsewhere, so far as I am aware, to support this **assumption**. **All** the evidence I have seen—and I have studied this question **carefully—abundantly** proves the contrary.

On the other hand, **it is** clear that restrictions which hamper and curtail the production and distribution of **margarine** and restrictions upon those who produce the **ingredients of margarine—more** than 2,300,000 American farmers. And, as I have **indicated**, they are **also** restrictions upon time welfare of the great livestock industries, of **needy people** at home and, abroad and upon the best interests of **the whole American people**.

I **hope** that all members, regardless of party affiliation, will study **the facts in** this **issue** carefully and without prejudice. I am confident, **if this is** done, that there **can be** but one outcome: **the antimargarine** laws will be, at long last removed from the statute book.

Senator FULBRIGHT. I may say, sir, I think it is a very thorough statement and one I hope all of the members will have time to read in detail.

Briefly this amendment very simply is to repeal the laws restricting the sale of oleomargarine.

The margarine laws restrict it in two ways. They impose a 10-cents-per-pound tax on colored margarine, and a quarter of a cent per pound on white margarine.

The more serious restrictions, however, are the license fees on distributors.

Not that that is such a great burden financially, although it is a considerable one, but that the licenses have the effect, because of the irritation of the regulations and supervision, of discouraging retail outlets to handle margarine at all.

That is the principal reason in my opinion why it is not available to the whole country. Less than half of the retail outlets handle any kind of margarine, and a very small percentage, I think about 5 percent, handles the colored. So it simply is not available.

Under present conditions, the 10 cents penalty on yellow margarine would not make so much difference, because, as you all know, butter is selling in the metropolitan areas for around \$1 a pound.

I was informed yesterday by my wife it is 82 cents a pound, whereas margarine is 42 cents. So you see it is not that tax so much, although unjustified, as the restrictions and the snooping that accompany the enforcement of it.

It is much worse than OPA regulations and their enforcement imposed during the war.

The history of this legislation I have in the statement, but I do not think that is particularly material.

It started, as you know, in 1886.

There have been three principal acts: 1886, 1902, and 1931.

When it originally started oleomargarine had very little in common with present margarine. In fact, the word is a misnomer, because it took its name from beef fat, the "oleo oil" which is not used today in an extent greater than 1 percent, and all of that for export.

Today it is entirely a different product.

I have the official definition of it here.

For the information of the Senate, that is set out in detail under the Food and Drug Cosmetic Act of 1938.

It is uniform. Today 99 percent has 15,000 units of vitamin A, 3,300 calories, the same as butter, and it has 80 percent of vegetable fat content.

Senator BARKLEY. Senator Fulbright, my departure does not mean a lack of interest in your statement.

Senator FULBRIGHT. I understand that,

As to the question about its purity today; there is no question about that.

I have here quotations from some of the leading nutritional scientists of the country.

The New York Academy of Medicine states, and I paraphrase, that there is no real distinction in its nutritional value.

They add, however, that margarine is much more uniform than butter. Whereas butter will vary in vitamin content from 500 to

20,000 units per pound during the course of the year, due to the seasons, margarine is fortified at the same amount of 15,000 units the year round, and in that sense is a more stable and preferable and superior product.

At this time of the year, butter has a small content, and in the season when they have grass it has a high content.

Senator CONNALLY. May I interrupt there by a suggestion?

I read in the press a week or two ago the statement, I think of the University of Illinois, where a group of scientists had exhaustively studied this matter and had applied it to 17 children.

Senator FULBRIGHT. May I correct you there? It is 217 children, I have that whole account of that experiment in detail.

Senator CONNALLY. That will answer the question.

They experimented with butter and oleo, and as a result, found that there was practically no difference whatever in the results in the children.

Senator FULBRIGHT. That is correct.

For the Senator's information, I have that. It was at the Illinois College of Medicine.

Drs. Harry Leichenger, George Eisenberg, and Anton J. Carlson who, by the way, is a very noted scientist in this field and has testified before the Senate, conducted a 2-year study of 217 children in two separate orphanages, where they could control the conditions very precisely.

One group used butter in its diet, and the other margarine, and here are some conclusions which I quote from their report:

Blood studies showed that there were so significant differences between the margarine and butter groups. The children in the margarine group experienced a high degree of good health during the study and in comparing their health to those in the butter group, it appears to have been much better.

When infirmity records are compared, it is readily seen that the margarine group fared better than the butter group. We are not making claims that the margarine group were healthier simply because their diet contained margarine. Other variables are more likely to account for their better health.

There have been many other reports on that point as to its purity and nutritional value.

I do not think that any longer is a point in the whole argument.

As to the question of fraud, I think that also has been cured.

You will remember at the time the original laws were passed, there were no pure-food laws at all. Today, not only do we have Federal pure-food laws, but 47 of the 48 States guarantee the labeling and standard of purity, and so forth, in the States themselves.

So, as to the fraud or purity standard, as such, I think there is no question there.

But, as to the question of imitation, it seems to me there is no real foundation to that when you analyze it.

If, in the first place, butter makers have a preemptive right to yellow and no one else should use it, the proper thing to do is to pass a law and say that no one should use yellow.

It is the wrong approach to put a regulation in the guise of a tax on this product and I do not think any body can justify it.

Lard is quite similar. Would you think the lard people could legitimately request that shortening made from other materials than hog

fat should be colored black, we will say, in order to distinguish from the natural color of lard?

Senator HAWKES. Mr. Chairman, may I ask the Senator this question? That is not a good illustration, from my point of view, because if you color something black to distinguish it, that is one thing. Here you are coloring something that is white, yellow.

Senator FULBRIGHT. I beg to differ with the Senator. The law does not permit the natural yellow in margarine to be retained.

It specifically makes you bleach out the natural yellow in margarine to assure white color. Otherwise, it is subject to tax.

Senator HAWKES. I understand that, and you are not advocating when it is colored it should not be subject to tax?

Senator FULBRIGHT. I am advocating repeal of all the taxes because I think there is no justifiable basis.

Senator HAWKES. How are you going to protect the people who go to a restaurant, and think they are buying butter, from having yellow margarine served to them that the people tell them is butter?

Senator FULBRIGHT. I think by direct legislation, the same way you prevent fraud in any other case; and that is, by a law which requires, if margarine is served, that consumers be given notice, on the menu, or other suitable place, with heavy penalties if the law is not complied with.

I have no objection to as heavy a penalty as you wish.

Senator HAWKES. I was coming to that. In other words, then, there should be some law that compels the restaurateur and the fellow that serves butter to you and me, at a high price, to put it on the menu that it is creamery butter or oleomargarine colored.

Senator FULBRIGHT. Absolutely.

There is no desire on the part of the people who oppose this kind of taxation that they have any opportunity to commit fraud.

As a matter of fact, all margarine today is sold in cartons on which full notice of the contents is given. Also warnings are printed on the carton as to what one may do with it.

It is interesting to see one of those cartons.

On the inside, it warns the grocer not to, by any means, mix yellow color with it, otherwise he is subject to the manufacturing tax of \$600 and should he do it without paying it, he is liable to a very severe criminal penalty. Even as a demonstration, must immediately throw

it away. He cannot sell it or give it away.

All of that is carefully taken care of now and the cartons of margarine state on the outside, as must all other foods except butter, that it is artificially colored.

Butter and cheese and ice cream are the only food products that are not required to abide by the general rule as to food products. They do not state they are colored artificially, although they are, except possible for 3 or 4 months of the years. And I think in most cases they are then because the creameries do not get uniform milk at any time.

But this "yellow" argument is based on the idea they were first in the field with yellow and no one else has a right to sell a spread for bread, that is colored yellow.

You say lard is not a good example. I think it is quite close.

will go a little further. I might recall that back in the early days of England, when cotton first came in, there was a law passed to prohibit the making of cotton cloth for the protection of wool, and they used great propaganda.

There were laws that you could not make shrouds out of cotton, or could not bury people in cotton; it had to be wool.

Of course, that broke down.

Today you will see in newspapers "Aralac" advertised as a substitute for wool. It is made out of skim milk, incidentally, a product of these same people who oppose the repeal of this law.

I wonder if this committee would be sympathetic with a law that "Aralac" could not be manufactured as white in order to look like wool.

And you could go on. I think you might as well say the early buggy manufacturers could come in and say, "Listen. These automobile people are going to use machines with four wheels. That ought not to be permitted. They ought to have five or three."

It is a ridiculous idea that a product has a presumptive right to a particular color. Even a patent right does not go on forever. If you invent something out of your own mind, which never existed before, it has only a limited duration.

And here they say they have for all time a right to use yellow and no one else can.

Senator LUCAS. Senator, would your amendment permit the margarine to remain in its natural color?

Senator FULBRIGHT. Oh yes.

Senator LUCAS. As I understand it, you said a moment ago that they are compelled to bleach margarine at the present time.

Senator FULBRIGHT. That is right.

Senator LUCAS. Under your amendment, they would not be compelled to do that?

Senator FULBRIGHT. Under this amendment what I seek to do is repeal all of the restrictive laws, both as to the licensing and coloring.

Senator LUCAS. If we did that, would the repeal of the law permit margarine people to add color to the margarine?

Senator LUCAS. In other words if it came out just a little yellow, they could add enough color to make it yellow?

Senator FULBRIGHT. Exactly, like butter does now.

That is what they are doing to butter today. The butter you ate this morning was colored.

If you look at the country butter this month, you will find it is no more yellow than margarine in its natural state. It is practically white. There is a slight tinge to it.

Senator LUCAS. I agree with you. I have seen butter come from the churn in the country, and a lot of it is pure white butter.

Senator FULBRIGHT. A lot of these creameries have butter which is colored. And this amendment would permit the margarine manufacturer to do it in his plant cheaper and without the waste of material that is placed on the housewife has to do it in the kitchen.

One of the manufacturers, not all of the manufacturers, encloses the margarine in a cellophane package, and within a hour in another container, is the coloring. So you break that by pressure and then knead it to put the color through it. They do that.

That **is** a very recent development within a year. Until that was invented, they had to take it **out** and put it in a bowl and **add the color**, and **mix it in**.

It was estimated by the Department of Agriculture, I believe, in the course of a year, around **11,000,000** pounds of margarine had been lost in that process.

The **CHAIRMAN**. Why should anyone want to go to all that trouble to make margarine **look like butter**?

Senator **FULBRIGHT**. That is a matter of taste. The same that you have with many other things.

Why **do** we wear these silly clothes we do when others are **much more comfortable**?

We are used to it and do it because it is the **custom**. It is purely a matter of taste that has developed through the custom of doing it that **way**.

We have many of those things that are **irrational**. No one can **say why** they do it.

Take a **necktie**. Why do you wear a necktie? It is one of the silliest things in the world, and yet we think we look funny without **one**.

That is **all** I know. You are used to the color of yellow, and therefore you want it.

The **CHAIRMAN**. But, do **you** want the margarine to look yellow for its **own sake**, or to look **like butter**?

Senator **FULBRIGHT**. Because of **taste** developed over the **years**. Most of our advertising is based on the same idea.

The butter people say because it imitates it, that therefore it is **bad**. But all the progress in our industry, in all its fields, has that **element of imitation** in it, a substitution **of** a better product.

The **CHAIRMAN**. I was wondering why a person would want to **go** all through the trouble of getting **the** margarine, which is **a** fine food, putting it in a bowl and adding color to make it look like something else.

Senator **FULBRIGHT**. I cannot explain that, but the fact is they do it, and the increase in the use of it in that form is very great.

I am unable to explain it, but it is a fact which **we** must recognize—the American housewife wants it that **way**.

The **CHAIRMAN**. You would not suggest they are trying to make it **look like butter**?

Senator **FULBRIGHT**. Why does the housewife do **it**?

The **CHAIRMAN**. You would **not** suggest they are trying to make it **look like butter**? Is that your **point**?

Senator **FULBRIGHT**. That is right, and why do the butter people color their **butter**?

The **CHAIRMAN**. There is a difference in coloring something to make it look **like** something else—

Senator **FULBRIGHT**. And coloring something to make it look like **itself**.

The **CHAIRMAN**. Like something which does not change its essential **character**.

A **lady** may think she **is** enhancing her charm with a powder or **a** **lipstick**; but **she is** still a lady. You are not taking an entirely **different** thing **and** trying to make a lady out of it.

Senator **FULBRIGHT**. You have gotten into a field, Senator, I am not an authority on. I will have to accept your word on that.

It has always been most difficult for me to distinguish between whether they have powder on or not.

Senator **LUCCAS**. Senator Fulbright, do you speak of soybeans in connection with this margarine?

Senator **FULBRIGHT**. Yes, indeed.

I have some very interesting statistics on the soybeans, and that is one reason why this bill has, I think, become politically possible, together with these other factors of purity and manufacture.

The significance of the soybean in this is very great, and I have the statistics on that in here.

Senator **CONNALLY**. One of your points is that if the butter people color their butter and oleomargarine also is colored by the producers, you do not think there is any reason why one should be taxed because it uses color and the other go through because it does?

Senator **FULBRIGHT**. I cannot see any reason for it at all.

The value of soybeans is becoming greater than the value of butter, and both are products of farms in the same area of our country.

The shifting of the whole dairy industry, which is the next point I wanted to pass to, is to things other than butter, not because of margarine, as I think the statistics will show, but simply because butter is the least profitable part of dairying.

I have a very interesting table which I will try to pass on to.

There is more than can be said on the yellow argument, but I think it has no real merit.

The real question, I think, is whether or not in the public interest the dairy industry should be protected. And do these laws protect it?

I think they do not protect it, even though you would say this is an industry that ought to be protected.

I think the facts will show these laws have not and do not and cannot protect it, butter, as such.

I do not think butter today has really benefited from it.

Senator **HAWKES**. Mr. Chairman, I would like to proceed with this color thing a little more.

The ordinary color of butter is yellow, is it not?

Senator **FULBRIGHT**. At certain times of the year.

Senator **HAWKES**. A substantial part of the year?

Senator **FULBRIGHT**. A small part; not the majority. Only in the spring months, when there is plenty of green pasture. It is the green grass that makes it yellow.

Senator **HAWKES**. Does anybody in the country think of butter as being anything but yellow?

Senator **FULBRIGHT**. No.

* Senator **HAWKES**. Now, then, the color of the other thing is white, or nearly white. When you say you have to remove the color, it is a dirty yellow.

Senator **FULBRIGHT**. I do not know why you say "dirty." It is just yellow.

Senator **HAWKES**. I am not talking against your matter at all. I am just trying to analyze the thing because we want to do the right thing.

But you have got a very substantial industry, and I do not think you will find the people from the creamery States agreeing that butter is a small part of the business.

Senator **FULBRIGHT**. The statistics **I** have here **are** from **the** Department of **Agriculture**.

Senator **HAWKES**. **I** have talked with them, and they think it is a very important part of their business. Just as **the** strap-hanger thinks more **people** sit down than stand up, but at the same time **the** strap-hanger is an important part of the income of the streetcar company.

I want to raise the point that you cannot fool anybody **on** this thing.

The truth of the matter is you believe that **oleomargarine**, even though its color is along the lines of muddy white, should **be** permitted to **be** colored because it **is** beneficial to the mental reaction of the public in eating it?

Senator **FULBRIGHT**. Because they want it.

I do not know how beneficial it is to their mental reaction, but **I** may **say**, since you mention **the** public, **I** think they do have an interest in this.

We **are** talking all **the** time about inflation, and so **on**, and nothing to **my** knowledge of any importance **has** been **done** by the **Government**, except in **the** restricted field of not reducing **the** taxes last year, and one or two things of that sort.

But here is a very concrete **way** you can make available to the consuming public some help.

The Senator's State is one of those consumers' States as opposed to butter producers, and you make available to them here a product at approximately **one-half** the cost of butter, which from all **the** evidence, is just as good for them, and one they want.

For the benefit of a very restricted class, you **say** because they first made a yellow table spread, **no one** else can make it.

Senator **HAWKES**. **I** am not saying that, and the fact that the consumers in my State predominate, would not affect me in the least in doing what **I** think is just and the fair thing.

Senator **FULBRIGHT**. But their interest is entitled to consideration.

Senator **HAWKES**. There is no doubt about that and we want to do **the** right thing, not **on** the basis of more votes for oleomargarine than for creameries.

Senator **FULBRIGHT**. If there is any justification for the creameries' position.

Senator **HAWKES**. **I** have seen too much of this thing already to think that you ought to vote for a thing you think is wrong because more votes **are** coming that way.

Senator **LUCAS**. The dairy crowd has had a pretty fair throttle upon the Congress during its time, and **I** do not know whether votes had anything to do with it.

Senator **FULBRIGHT**. They had had much **the** better of the argument.

They have kept the law for 62 years, and there **are** some very strong vested interests in this law.

If this law were repealed, a lot of people would not have very much to do.

In the last test on this case, they got twice as many votes.

Senator **CONNALLY**. Under the present pure-food laws, a manufacturer could not sell oleomargarine as **butter**?

Senator **FULBRIGHT**. **No**.

Senator **CONNALLY**. He would be penalized. Take a housewife, as she goes into a grocery store, the grocer cannot sell her oleomargarine **on** the pretext it is **butter**?

Senator **FULBRIGHT**. No.

Senator **CONNALLY**. If they want to buy it, and it is there, and she prefers to buy it, why should she be taxed for that privilege?

Senator **FULBRIGHT**. I see no reason.

There is no question about deception, as far as buying in a grocery store goes. The only point in that whole field is one raised by the chairman in the selling of it in a restaurant where you cannot put tile label on the pat of butter. It has to be handled by necessity on the menu or somewhere like that.

All margarine is labeled very clearly today—all about it, what is in it, how to handle it, and everything else.

The **CHAIRMAN**. Senator Fulbright, you are not making any contention this has immediate relevance to the income-tax reduction bill?

Senator **FULBRIGHT**. It has relevance to the tax bill. It is a tax measure.

I do not think it is a bona fide tax measure, but we have to be bound by the Supreme Court decision that it is.

It really is regulation. It is not a revenue-producing measure. What it produces is so small, I think if the truth were known, although I could not ascertain it, that the administration costs are more than the taxes bring in. It brought in less than \$5,000,000 last year.

They have, of course, this very large organization to supervise it, and the organization is opposed to the repeal, just as any bureau of the Government would be opposed.

The **CHAIRMAN**. I suggest Senator Connally has pointed a possible bourse of distinction that might be kept in mind. That is to say, the tax on the product as such, as distinguished from a group of taxes that might be intended to reach this alleged imitative angle.

Senator **FULBRIGHT**. I am afraid I did not follow that.

The **CHAIRMAN**. Senator Connally pointed out there is no more reason for taxing oleomargarine, as oleomargarine, than for taxing all sorts of other products, if I understood the Senator correctly.

Senator **CONNALLY**. That is right.

The **CHAIRMAN**. If I understand you correctly, there is such a tax you are complaining of.

Senator **FULBRIGHT**. That is right.

The **CHAIRMAN**. There is also a series of taxes that are intended, rightly or wrongly, to reach this imitative feature; is there not? And is there not a line of distinction between the two taxes?

Senator **FULBRIGHT**. Would I gather from the Senator that if all margarine is sold under its own name there is no question about your being willing to remove the tax?

The **CHAIRMAN**. I am not saying what I would be willing to do at all. I am merely suggesting there may be two prongs of argument.

Here you have raised one that goes to excise taxes on the product itself as such, and another series of taxes that are intended, rightly or wrongly, to prevent imitation.

Senator **FULBRIGHT**. In the first case, you mean an illustration would be a tax on liquor, for example. Just a straight excise tax on it, as whisky.

The other kind, the second prong you are talking about, seems to me ought to be reached, if at all, through a direct regulatory statute and not a tax law.

I do not know of any other illustration in our tax system where you seek to prevent the sale of a product that you think is fraudulent by a tax measure.

The CHAIRMAN. I am not arguing that, Senator.

I am merely suggesting that you have two points here; the arguments of which do not turn on the wisdom of both points.

In other words, a common argument will not turn the wisdom of both of the points.

Senator Connally points out you have got a tax on oleomargarine, as such, and he queries that.

It has been suggested that there are a series of taxes to prevent imitation. You cannot use the same argument to solve both barrels of your gun.

Senator **FULBRIGHT.** The only one I was interested in in this particular discussion was the 0 cents on yellow margarine. That is the argument. I was trying to make that argument, not to relate to that the one-quarter of a cent on white margarine which is comparable to an excise tax on liquor.

The CHAIRMAN. I understood you wanted to take that off, too.

Senator **FULBRIGHT.** I simply want to take it off, because I do not think a food product is the right product for excise taxes. That, I think, is clear.

I think that is only an adjunct to the other and principal objectives of these laws, which is to restrict and prohibit, if they could, the sale of margarine as a competitive product.

I do not think there are any "bones" about that being its real purpose. That could easily gather from testimony in 1944. There have

been very extensive hearings on this whole matter, and as the Senator well knows, there are volumes on it.

I have tried to read most of them.

But if it were solely a question for the committee, or Congress, to decide, whether or not we want to tax butter or margarine at one-fourth of a cent a pound, I do not think there would be any difference. Surely, you then could not distinguish between butter and margarine if that was all that was involved.

You could hardly make a distinction between two spreads on an excise tax.

So, I was not really thinking about that at all,

The objective of the butter people has been stated very clearly.

For example, I might quote the Dairy Record, a magazine representing the dairy industry. They said in an editorial on June 18, 1941:

The dairy industry must set as its goal the complete extermination of oleomargarine. It must never rest until the manufacture and sale of oleomargarine have been outlawed in this country.

So, there are no bones about it, they are not worried about the distinction as to imitation and so forth. They just think it ought to be outlawed.

Senator **HAWKES.** Do they give any basis for that, Senator? That does not sound sane to me. The thing is usable and many people like it better than butter.

I have a daughter who buys oleomargarine and has it on the table even when butter is available. So, there are people who like oleomargarine whether colored or not.

Do they give any reason for saying **the sale of this thing must be absolutely stopped?**

Senator **FULBRIGHT**. They feel, if it is not, it will destroy the butter industry.

Senator **HAWKES**. That is not a good reason.

Senator **FULBRIGHT**. That is the only reason I ever heard of.

I agree completely it is not a good reason.

Senator **HAWKES**. The only reason I have heard, I have heard **butter** has been served people supposedly, and it was oleomargarine. I have had it and have spread it on my bread, and then I could tell the difference when I ate it.

All I am interested in is preventing fraud on the public.

Senator **FULBRIGHT**. I am in complete accord with the **Senator** on that, but I say the proper way to do it is a direct, regulatory law with stiff penalties, and I am joining in as stiff a penalty as he thinks necessary.

There is no limit to what I would be willing to do on a direct regulation to avoid that sort of thing.

You can see that is not what they avoid by a tax of this kind.

I do not believe the Senator can think of an analogous situation where we have sought to prevent fraud by the indirect approach of a tax law.

If it is bad and should not be colored, then why do we not outlaw it and say, "You cannot do it at all."

That is the only logical and sensible way to do it.

They did not dare do it that way because they do not have sufficient ground to do it. I think it is ridiculous on its face.

What they have been able to do is maintain this thing that started 62 years ago under conditions wholly different from what they are today. That is the history of it.

There are other quotations in here I need not bother about.

I wanted to get some of the figures which I think should be persuasive on the dairy people themselves.

You realize there are certain organizations in butter alone which think so. I grant that.

I was drawing the distinction between that part which makes butter and the whole dairy industry

The political strength of this organization has been to make the whole dairy industry think it was to their interest to maintain this discriminatory legislation, whereas I think as a matter of fact, while it will help the butter manufacturer, himself, it does not help the dairy industry as a whole.

That is at least my argument, and I believe it is true.

I want to note a few facts.

Following the enactment of the last Federal antimargarine legislation in 1931, per capita butter consumption fluctuated within narrow limits, dropping from 18.1 in 1932 to 17.8 in 1933, rising briefly to 18.2 in 1934 and then dropping to 17.1 in 1935.

I think that is fairly significant. It dropped down gradually until 1946, when it was 10.5 pounds, almost one-half. But in the meantime, margarine did not take up that slack at all.

What this has done it has injured and held back margarine, but it has not really helped butter.

Senator **HAWKES**. May I ask you this: Was that drop from 19 pounds down to 10 due to the fact there was not any butter available?

Senator **FULBRIGHT**. No; in some of those periods, it did not jump up at all.

Senator **HAWKES**. Of course, in 1946, I imagine, there was a shortage of butter, was there not?

Senator **FULBRIGHT**. That was after the war.

Senator **HAWKES**. I know.

Senator **FULBRIGHT**. Here is a shortage in this sense: what has happened, the dairy people have diverted their product into the more profitable lines.

I can go to that right now. I have the table here showing exactly what happened. Take, for example, the utilization of whole milk, and these are Department of Agriculture figures.

Fluid milk and cream, the average 1935-39 was 44,000,000,000 pounds.

It went up in 1946 to 59,000,000,000 pounds. That is an increase of 35 percent.

In ice cream, it was 3,083,000,000 in that base period to 8,420,000. That is an increase of 173.1 percent.

I need not go through all of the figures.

There was an increase of 64 percent in cheese in the same period.

In the utilization of milk in these other fields, evaporated milk was 51.5 percent; condensed milk an increase of 34.7 percent; and dried whole milk, an increase of 992 percent.

That is remarkable. Here it increased from 146,000,000 to 1,448,000,000 pounds.

Senator **HAWKES**. That is dried milk?

Senator **FULBRIGHT**. Yes.

The reason for it? The return from butter fat sold as butter is the least profitable way you can market your milk.

Senator **HAWKES**. May I ask you a question there, because it is amazing when you say that. Why would the dairy group conduct a lobby, as you say, for 62 years, to do this thing if the butter business was the least profitable way to get rid of their milk?

Senator **FULBRIGHT**. I think you ought to distinguish between the dairy group and the butter group, and there is a distinction.

Senator **HAWKES**. You said the lobby was the dairy group.

Senator **FULBRIGHT**. No; butter. The Butter Institute is their organization, which is the primary organization interested in this.

I think they have made some dairy people feel this is an integral point.

* Let me make that other point about the price, and then I will come back to that.

The average price paid to farmers for butter fat sold as fluid milk or cream during the 10-year period, 1936 to 1945, was about 74 cents a pound. For milk sold as butter fat, that is, in the form of butter, 37 cents per pound.

There is a very complicated system of prices.

You say why do the dairy people support these taxes. I think it is interesting. There are a whole lot of them who do not, and I have some quotations on that point, objecting to the so-called formula for the setting of the price of milk in such places as the Boston milk shed.

Senator **HAWKES**. By whom was that article written that you read a few moments ago, where their ultimate goal was to get oleomargarine totally destroyed?

Senator **FULBRIGHT**. This is in the Dairy Record. That is a magazine representing the dairy industry, and I read what they said in an editorial.

I say that a lot of dairy people think this is to their advantage, but I do not think it is, and the people who are really concerned about it are specifically the butter industry.

But the butter end of the dairy industry has become a very small part of it.

Senator **HAWKES**. You see what I am thinking of; do you not? I wondered why, if the dairy group got more money for their fats in other forms, that the dairy magazine would advocate the elimination of this oleomargarine. In my business, we have always tried to put all of the raw materials and things we had in the most profitable items.

Senator **FULBRIGHT**. That is what they are doing.

Senator **HAWKES**. I think if those facts are correct, the dairy group would be down here backing you on this move.

Senator **FULBRIGHT**. Exactly what they are doing, is selling their whole milk in these other forms rather than butter. That is the reason these tremendous decreases in butter production have taken place, pretty nearly 50 percent, in spite of all the protection they have had during this period as a result of these taxes.

Senator **HAWKES**. What I want to know is: Are they backing you on this thing?

Senator **FULBRIGHT**. No; they are not.

Senator **HAWKES**. They ought to be if those figures are correct.

Senator **FULBRIGHT**. I think they ought to be, too.

You are familiar with the fact there are some very capable representatives of the butter industry here in Washington who are led by one of the ablest men, I have been told by some of the older Senators, who ever represented any industry in Washington.

Senator **HAWKES**. I would not think the butter industry was big enough and powerful enough to keep the Congress on the wrong track.

Senator **FULBRIGHT**. I can say I confess I was amazed at it, too. If you talk to some of these older Senators around here, they will tell you it has been.

Here are a few facts. In the State of Wisconsin, which has been thought to be the leading butter State, in the mind of many people, the income from the sale of whole milk, as a percentage of the total dairy income, in 1936, was 79 percent; 1941, 89.8 percent; 1946, 98.64 percent. The income from the sale of butterfat was 21 percent, in 1936, down to 1.36 percent, less than 2 percent; 1.36 percent of the total income from the dairy produce of Wisconsin, you see, and so on.

Take your part of the country. I think you would fall in the North Atlantic States.

In 1936, for nine North Atlantic States, 96.6 percent was sold in the form of whole milk. Up to 98.4 percent in 1946, and only 1.6 percent sold as butter in those nine North Atlantic States.

Senator **HAWKES**. Have you got any figures to show what part of that is sold in the regular form of milk and used for the production of butter outside of the dairies?

For instance, I might run a butter factory of my own and might
 large volumes of milk and make butter.

Senator **FULBRIGHT**. This says, "income from sale of butterfat and
 farm butter as a percentage of total dairy income."

Senator **HAWKES**. I thought maybe you knew.

Senator **FULBRIGHT**. If you sell it to a creamery for butter, of course,
 that would fall in this category over here. If it is sold in the forms
 I mentioned, in fluid milk and cream, it is over here.

Senator **HAWKES**. That is a terrible drop.

Senator **FULBRIGHT**. Surely it is.

Do you realize the production of butter during this period has de-
 creased 600,000,000 pounds, or approximately 20 percent? You see
 what I am getting at.

I did not make these figures up. They are from the Department of
 Agriculture. I do not think they can really be disputed.

Margarine has by no means taken up that slack.

The **CHAIRMAN**. What is time point that you are working on now?

Senator **FULBRIGHT**. That the taxes are not protecting the dairy in-
 dustry and not benefiting the dairy industry, as a whole, that is, the
 producer of milk, the farmer who has cows.

I will not say it has never had any influence on butter alone, although
 I think it is doubtful.

I think they kidded themselves about the effect of margarine.

I think the beneficial effect of the laws to them is very doubtful.
 Their real solution is to pursue the things they are now pursuing
 and sell it in the forms I now mentioned.

I hope the Senator will read this statement. It is much more co-
 ordinated than my statement is now. It is much more logical and
 precise.

But I was trying to show what the problem is and what is happen-
 ing. I do not think the dairy industry, as a whole, is threatened by
 extinction.

When I mention the decrease in butter supply, I, by no means, leave
 the impression of a decrease in milk production; that has greatly in-
 creased from 102,000,000,000 pounds to 120,000,000,000, and there is
 still a shortage.

Butter, in the meantime, has about priced itself out of the market,
 selling now up in the neighborhood of \$1 a pound, that is in New York,
 and here in Washington it is around 90 cents.

I hope I have just at least indicated enough that it will inspire
 you to read this report fully.

Senator **HAWKES**. I assure the Senator I will read the full report.

Senator **FULBRIGHT**. There are one or two other points I just want
 to indicate.

It used to be thought this was all a question of cottonseed as against
 the butter industry. In the past, politically speaking, it was regarded
 purely as a Southern issue, but this matter of soybeans has come in
 to make it a Nation-wide issue, from the standpoint of the producers'
 interest.

I wanted to read a few facts on that.

First for the fiscal year 1946-47, according to the Bureau of In-
 ternal Revenue, 47.4 percent of the vegetable fat used in margarine

was cottonseed oil; 41.5 percent was soybean oil; and 3.1 percent was peanut oil. Corn oil and other vegetable oils account for the remainder.

That, you can see, is a very small percentage. The total farm value of the cottonseed produced, in 1946, was \$246,473,000. This was spread over 1,600,000 cotton growers.

Then in 1946, 222,000,000 pounds of cottonseed oil was used in margarine.

I have here figures on the soybean production and its remarkable growth.

In 1924, total production of soybeans for sale as beans was 4,947,000 bushels; in 1933, 13,509,000 bushels; in 1939, 90,141,000 bushels; in 1946, 196,725,000 bushels, or 41 times as much as in 1924.

That is spread over some 30 States, and the real center of the industry is in the Middle West, in that same area, in which States that used to be so interested, and still think they are interested primarily in butter, producing more soybean oil than butterfat in value.

The value of soybeans has increased from \$12,698,000, in 1933, to \$73,052,000 in 1939; to \$517,387,000 in 1946, approximately the same value as butter for the whole Nation.

Senator HAWKES. What is that soybean oil used for principally?

Senator FULBRIGHT. I have the exact figures, but one of the uses is in margarine. It is used for other purposes, lacquers, and so forth.

Senator HAWKES. I realize that and I wanted to know if you had figures showing how much was used in margarine.

Senator FULBRIGHT. Yes.

Senator GEORGE. About 41 percent of that total, almost half of it.

The CHAIRMAN. You gave us the percentages just a few moments ago.

Senator HAWKES. Mr. Chairman, what I wanted to know was whether that percentage he gave us is used directly and only in margarine.

The CHAIRMAN. What he said was margarine is made out of so much percent of this and of that.

Senator FULBRIGHT. That figure is so much margarine out of soybean oil.

He wants the figure on the total percentage of soybean oil that goes into margarine.

Senator HAWKES. That is right.

Senator FULBRIGHT. The percentage of soybean oil used in the manufacture of margarine in the 10-year period between 1937 and 1946, inclusive, varied from 16.3 to 22.1 percent.

I have made several statements on this, and it is possible I may have omitted it in this one and put it in another. It is readily available.

There are a great many interesting figures that fortify that.

You have cash receipts, for example, from the soybean crop and from butter just as an illustration.

As I gave the figures in that illustration of Wisconsin, I have a great many States giving those same figures.

As an illustration, the soybean crop in Illinois for 1946 amounted to \$183,000,000 plus, whereas the butter and butterfat was \$20,000,000.

Iowa was one of the few in which the butter outweighed the soybeans.

It was \$82,000,000 for soybeans, as against \$111,000,000 for butterfat.

Take Indiana, right in the middle of the Midwest: \$56,000,000 in soybeans, and \$12,000,000 butterfat.

In other words, soybeans were 488 percent of the value of butter.

Ohio was \$36,000,000 for soybeans and \$12,000,000 for butterfat, or 308 percent; and Missouri was 154 percent.

There has been a great misapprehension about the relative value to the people of these States of these two industries.

There is one other very interesting fact which I only found out myself within the last few days.

This is Iowa State College. This is in the same State I mentioned as one of the few in which butter is of greater importance than soybeans.

This is Iowa State College, which published the fact that 1 acre of soybeans will produce as many pounds of vegetable fat as 2 acres devoted to dairying will produce of butterfat. Their report stated also that one man-hour of labor will produce 13.3 pounds of soybean oil compared with only 1.5 pounds of butterfat.

And we are always talking about increasing production efficiency, the use of lands, and so on.

I just found that out within the last few days, and I think those facts are very startling-

The Iowa State Survey concluded by recommending that--

restrictions on the sale of margarine, State excise taxes, license fees, et cetera, should be removed so that its consumption may be encouraged.

C.F. Christian, farm-marketing specialist at Ohio State University, also studied this problem recently, and states his conclusions as follows:

The dairyman raises an acre of grain, usually corn, and has another 2 acres in hay or pasture to produce 225 pounds of butter. The acre of corn will take at least 80 hours' work and hay and pasture require more work, and care of the cows will involve another 150 hours in producing 225 pounds of butter.

An acre of soybeans can be grown with 14 hours of man labor and will make about 225 pounds of margarine.

A pound of butter represents 10 times the amount of farm labor and 3 times the amount of farm land that is represented by a pound of margarine.

I think, when you get down to the basic economic facts, there is one which is most significant.

I think this tax law is a vain effort to try to bolster up an industry that is having great difficulty not because of margarine, because you will see margarine has not taken up the slack, but it is, I think, a fundamental economic fact of production and cost of production for the butter that has entered into the picture.

I just want to say it seems to me the net effect of these laws has not been to keep butter up as distinguished from the dairy industry, but has been to hold down and prevent the development of margarine, the margarine industry primarily, and I think principally because of the limitations on outlet.

I really think that is more significant than the 10-cent tax when it comes down to what is happening, because these dealers and grocery people are not going to put up with this snooping about and keeping track of every little pound they may have and seeing that it is kept just according to certain regulation of this Department.

I think you are familiar with such regulations: That people cannot take margarine out and sell it like butter. You have got to have an order before you go out and sell it, and you have got to keep strict account of how much you received, and they check up just like they do if you are selling drugs.

It is a curious thing that fees for handling margarine, a perfectly wholesome food product, are considerably more expensive than if you are a dealer in heroin or morphine or something of that sort. It is a curious thing.

Mr. Chairman, I apologize for taking so long, but I submit this for the record.

It is a complete statement which fills in the many gaps in what I have said.

I would like to submit individual copies to the members of the committee if you think it would be all right to do so, as soon as they are ready.

They will be ready in the next day or two.

The CHAIRMAN. Our difficulty is a practical matter, as we have more or less agreed we would confine our hearing to income-tax reduction.

It might develop in the view of the committee this is more relevant in connection with further bills we might have of a general revision nature.

I am not authorized to make any final decisions on the subject, but we are hearing you this morning out of courtesy to you and not because the subject is relevant to what we intend to develop at these hearings.

Senator FULBRIGHT. I would like to say particularly for the benefit of the Senator from the State of New Jersey who evidenced some moments ago some wonder about the power of the butler interests, the real reason this amendment is submitted to this bill is a very practical legislative one. That is, that over the years the people interested in repealing this legislation have never been able to get such a bill out of committee.

In the House of Representatives, by special resolution of the House, such legislation goes to the Committee on Agriculture rather than to the Ways and Means Committee, where tax legislation, as you know, normally goes.

Whereas it is justified before the courts as a tax measure, in the House of Representatives it is treated as an agricultural matter, and therefore has been successfully bottled up for 62 years.

The only reason we felt we should do this is that any opportunity we had to get a vote was to attach it to a bill we knew was going to be voted upon.

You speak of tax bills which may come up in the future. Certainly there is no assurance that any other tax bill will come up in this session.

But from what you read, you think the only tax bill that may come up for a vote is the bill to which this amendment is offered.

I am not impatient with the regular course, but we felt the only hope of getting any expression from the Senate and the Congress was to follow this procedure.

It has been tried the other way many times and over the course of many years.

I think the Senator recognizes the only reason for attaching it to this bill is not because it is an income-tax bill, but the only opportunity we think we have got to get a vote on it, and it is, under the rules of the Senate, germane to this bill I am told by the Parliamentarian.

The CHAIRMAN. The Senator will appreciate also I am not indicating the final attitude of the committee, but he will appreciate the committee might want to limit its work this round to income-tax reduction.

Senator FULBRIGHT. Would it be proper to inquire of the Senator if he believes there will be another bill dealing with excise taxes out of this committee?

The CHAIRMAN. I can say this: The House, as I understand it, is working, as the Senator knows, on a vast field of possible revision legislation.

I have no authoritative reason for saying this at all, but I have heard that they are also considering whether, in connection with a later bill dealing with revisions, also to add on provisions to take out, for example, the more atrocious excise taxes, or to reduce them.

But I am not in a position to make an authoritative prediction on that subject. Except, so far as I am concerned, if the surplus after we get further into the session would warrant a bill of the type I have just discussed, personally I would hope very much one would come over here from the House.

Senator **FULBRIGHT.** Is there not an excise bill reducing taxes on church organs, and so forth, before this committee?

The CHAIRMAN. Yes.

Senator **FULBRIGHT.** Is it the committee's intention to bring that bill out?

The CHAIRMAN. We have no present policy as to that bill.

Our present intention agreed upon prior to the beginning of these hearings is that we would concentrate first on an income-tax-reduction bill.

Senator **FULBRIGHT.** I inquired only because if I thought you were going to bring that out, I would be perfectly willing to have this considered with that.

The CHAIRMAN. The senator, of course, is entitled to his whole field of maneuver under all the rules of the Senate, but I would suggest, myself that a more appropriate time to bring up this particular matter would be in connection with some later bill.

Senator **FULBRIGHT.** I thank you, Mr. Chairman and members of the committee.

(The following table was submitted for the record :)

Production of specified fats and oils in the United States, and quantity used in the manufacture of oleomargarine as a percentage of production, average 1937-41, 1946, and January to October 1947

Item	Average, 1937-41 ¹		1946		January to October 1947	
	Production	Percentage used in manufacture of oleomargarine	Production	Percentage used in manufacture of oleomargarine	Production ¹	Percentage used in manufacture of oleomargarine
	<i>Pounds</i>	<i>Percent</i>	<i>Pounds</i>	<i>Percent</i>	<i>Pounds</i>	<i>Percent</i>
Cottonseed oil.....	1,472,000,000	9	966,000,000 ⁵	23	760,000,000	31
Soybean oil.....	419,000,000	15	454,000,000	14	1,267,000,000	15
Peanut oil.....	87,000,000	3	101,000,000	14	107,000,000	1
Edible tallow, oleo oil, ¹ oleostearine, and oleo stock	213,000,000	0	124,000,000 ⁰⁰	4	151,000,000 ⁰⁰	4
Lard, including rendered pork fat.....	1,984,000,000 ¹	(¹)	2,138,000,000	(¹)	1,829,000,000	(¹)

¹ Preliminary.

⁰⁰ 0 percent

¹ 0.1 percent.

Source: Bureau of Agricultural Economics. Computed from report of the Bureau of the Census, Bureau of Internal Revenue, and United States Department of Agriculture.

The CHAIRMAN. We will recess until 10 o'clock Friday morning.

(Whereupon, at 12:40 p. m., the committee recessed to reconvene Friday, March 5, 1948, at 10 a. m.)

REDUCTION OF INDIVIDUAL INCOME TAXES

FRIDAY, MARCH 5, 1948

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

The committee met at 10 a. m., pursuant to adjournment, in room 312 of the Senate Office Building, Senator Eugene D. Millikin, chairman of the committee, presiding.

Present: Senators Millikin (chairman of the committee), Taft, Hawkes, Martin, George, Barkley, Connally, Johnson, and Lucas.

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

Our first witness is Mr. Mitchell.

Mr. Mitchell, will you state your full name, your residence and your occupation.

STATEMENT OF DON G. MITCHELL, CHAIRMAN, TAXATION COMMITTEE, NATIONAL ASSOCIATION OF MANUFACTURERS, ACCOMPANIED BY JOHN C. DAVIDSON, MANAGER, GOVERNMENT FINANCE DEPARTMENT; GEORGE HAGEDORN, ECONOMIST; AND DR. HARLEY L. LUTZ, TAX CONSULTANT, NATIONAL ASSOCIATION OF MANUFACTURERS, NEW YORK, N. Y.

Mr. MITCHELL. My name is Don G. Mitchell. I am president of Sylvania Electric Products, Inc. I am also chairman of the taxation committee of the National Association of Manufacturers. This statement is made in support of the tax bill, H. R. 4790, which is now before your committee. I also will present data on the shortages of investment capital which indicate the need for more thoroughgoing reduction in taxes.

Before I begin, I would like to ask if I may be granted the privilege of reading my entire statement without interruption. It will take about 30 minutes.

The CHAIRMAN. We will try to do that, but I can make no guaranty.

Mr. MITCHELL. After which I shall be most happy to attempt to answer any questions the Senators may care to ask me.

I should also like to introduce to you gentlemen three advisers who have accompanied me and to whom it may be necessary for me to refer in order to answer your questions accurately. They are, on my left: Jack Davidson, manager of the Government Finance Department of the National Association of Manufacturers; next on the left, George Hagedorn, economist of NAM; and still further left, Dr. Harley L. Lutz, tax consultant of NAM.

Senator LUCAS. You have nobody on the right?

Mr. **MITCHELL**, I will be far enough right in my statement to take care of **that**.

The correct view to take with regard to **H. R. 4790**, in our opinion, is that it is a step in the proper direction, but to recognize that it is only a transitional **phase** in the movement toward a more **thorough** revision and readjustment of individual income-tax burdens. This judgment is expressed on the **form** of the bill as it passed the **House**. Obviously if the measure should be revised in **the Senate**, so as to diminish **the amount** of tax reduction that would result in private savings, the legislation would **do** even less toward meeting **the fundamental** needs of **the economy**.

In other words, we support the bill as **the best**, and in fact the **only** tax bill that can be enacted at this time. It will provide a welcome tax relief to those with small incomes, and also for time correction of **the situation** which **now** exists as to income taxpayers in **the community** and **noncommunity** property States. **The rate** reductions will help **all along** the line. However it will result in only limited additional **capital formation** out of individual savings, and particularly of **the venture** or **equity type**.

This is shown by data submitted by the Secretary of the Treasury in his testimony on **H. R. 4790** before the Ways and Means Committee. According to one of the tables appended to **the Secretary's statement**, the estimated tax reductions in the net income classes to which **the Nation** must look for the great bulk of its venture capital—those of \$10,000 and over—would be \$1,609,000,000. We estimate that 80 percent of any savings through tax reduction in **the net incomes** of \$10,000 and over would be saved. **The total savings** resulting from enactment of the tax reduction provided by **H. R. 4790**, in these **net income classes**, would therefore be \$1,288,000,000. If we assume that as much as half of the total savings would be applied to venture capital formation, the total addition to this kind of capital which **the House bill** would make possible would be \$644,000,000. While such an amount would, of course, be welcome and helpful it is **very far short** of **the total amount** of venture capital investment that **the economy** needs and must have in order to continue its advance.

Assuming that we want to continue to do business on the free-enterprise basis, there is a point beyond which our incomes must not be taxed if this country is to have enough **capital—enough** jobs, wages, goods, and profits. This point is reached when it is **no longer possible** to set aside enough national "seed corn" to grow bigger and better crops next year and the year after that. Our national "seed corn" is **the part** of the annual product that is put back each year in **the Nations** capital plant and equipment. In other words, it is capital formation.

Data from 1869 through 1930 compiled by **the National Bureau of Economic Research**, and later corroborated by United States **Department of Commerce** data, show that **during the** 60-year period about **one-fifth** of **the Nation's** total production was needed, decade after decade, for investment.

In that same period, this annual contribution to capital formation led to eight times as much **production**, or at an average rate of 3.8 percent increase per year, compounded annually.

During the same period, productivity of labor doubled as the result of the worker being given more and better machinery and tools with which to work. And at the same time labor's real wages—purchasing power—doubled.

The record of those six decades is unequalled by any other nation. But the record of the next decade, 1928-38, is equally significant—the other way round. In not one of these years did capital formation reach one-fifth of the national output. And this was the first decade since the Civil War when the level of production did not advance. Without an adequate flow of capital, the American people did not prosper.

Without wishing to imply that lack of capital formation caused the depression of the thirties, there is significance in the fact that during that decade of deficiency of new capital, there was no prosperity.

Now, however, with national income and employment at peak peacetime levels, sufficient capital from private savings to regain our pre-depression stride cannot be accumulated because of Federal taxes.

Sound taxation would estimate and allow for the deficit in capital formation which has to be made up, and the imperative need for new capital. If the Nation does not have thoroughgoing tax reform, over-taxation will kill the goose that lays the golden eggs of better jobs, better wages, better goods, lower prices.

What, then, do we need in dollars of capital to keep our Nation moving forward at its predepression rate of 3.8 percent a year?

In answer to this question, I submit a table compiled from data published by the Department of Commerce, the President's Economic Report, and other official sources.

THE CHAIRMAN. Where is the table?

MR. MITCHELL. The table follows.

THE CHAIRMAN. I see. The table will be inserted in the record at this point.

(The table is as follows:)

Future capital requirements compared with capital funds expected to be available

(Billions of dollars)

	Actual—		Annual average (projected)	Annual average (projected)
	1946 ¹	1947 ²	1948-52	1953-54
	(a)	(b)	(c)	(d)
PRIVATE CAPITAL REQUIREMENTS³				
1. For financing gross private domestic investment.....	21	130	39 ¹	47
2. For financing net private foreign investment ⁴	3	5	5	0
3. Total capital required.....	28	135	44	47

¹Actual amounts, which are less than the historical percentage of gross national product.
²Net private foreign investment. The 1946 and 1947 data are derived from material provided in the President's Economic Report, pp. 29 and 30 (in billions of dollars).

	1946 ¹	1947
Export balance (excluding unilateral transactions).....	4.8	8.8
U. S. Government foreign loan.....	1.	3.6
Balances from private capital.....	3.3	5.2

Future capital requirements compared with capital funds expected to be available—Continued

[In millions of dollars]

	Actual- 1946 ⁵ (a)	1947 (b)	Annual average 1948-52 ² (projected) (c)	Annual Annual 1953-54 (projected) (d)
PRIVATE CAPITAL AVAILABLE				
4. From reduction of liquid asset holdings of business.....	6	2	2	0
5. From commercial bank loans.....	5	6	4	4
6. From Government subsidies.....	1	1	1	1
7. From financing through institutions,..... from venture funds provided directly by individ- uals.....	2	6	6	6
8. Increased equity in homes.....	1	0	1	1
9. Increased equity in unincorporated business.....	2	3	3	4
10. Net investment in corporate securities.....	0	0	0	0
From internal savings of business:				
11. Capital consumption allowances.....	11	12	10	12
12. From retained corporate profits.....	2	6		
13. Total capital available.....	30	35	36	40
14. Annual capital deficit.....			8	7

Mr. MITCHELL. This table shows actual private capital requirements and private capital available, for the years 1946 and 1947, and projections of these data through the year 1954. The projections of the amounts of capital to be available in the years ahead are on the assumption that present tax laws will not be changed.

In other words, that is what will happen if we do not watch out.

The table is based upon the revised concepts of gross national product and national income which were published by the Department of Commerce in the Supplement to the Survey of Current Business for July 1947. Because of the statistical modifications made, the historical trend of the relationship between gross product and capital formation becomes 15 percent in the new series as against 20 percent in the old series. The projected private capital requirement shown in the table is computed at 15 percent of gross product, and it is assumed that the maintenance of this rate of capital formation will lead to a resumption of the historic rate of annual growth, which has been 3.8 percent per annum.

The CHAIRMAN. Has that been an average rate?

Mr. MITCHELL. An average over the 60-year period to which I referred previously.

The CHAIRMAN. So that in some years it might have been more and in some years it might have been less?

Mr. MITCHELL. Definitely, yes.

Senator MART. That 60-year period ends in 1928?

Mr. MITCHELL. That is the 60-year period which I referred to before, which ends in 1928; yes.

On the basis of these assumptions, we find that the average annual capital formation requirement that will be needed to maintain a healthy growth in the economy will be \$44,000,000,000 during the 5 years 1948 through 1952, and that it will rise to \$47,000,000,000 in the years 1953 and 1954, even on the assumption that in 1954 there will be no need of net foreign financing from private sources. Should that need still exist, the aggregate requirement for capital formation would be even greater than the table indicates.

The CHAIRMAN. What is your assumption as to the purchasing value of the dollar?

Mr. MITCHELL. Do you have that, Jack?

Mr. DAVIDSON. I think it makes no difference, as the relationship of the several figures would not change much under any circumstances.

Mr. HAGEDORN. The dollar volume of the estimates are on the assumption that the present value of the dollar will continue.

Mr. MITCHELL. If you will refer to the numbers on the left-hand side of the table, those will refer to the lines to which I am referring.

I will now present a brief explanation and justification of the assumptions made with respect to each source of capital shown in the table.

Reduction of liquid assets of business: Line 4 of the table shows funds made available for capital formation by reducing business holdings of liquid assets. These assets have been looked upon as a substantial source of capital funds for a number of years after the war, but indications now are that the process of converting those assets has already drastically tapered off and is nearing an end. According to Federal Reserve Board estimates, holdings of liquid assets by all business declined by about 6.5 billion dollars in 1946. A comparable figure for all business is not available for 1947. However, the President's Economic Report states that the reduction of corporate holdings was 5.5 billion dollars in 1946 and only 1.5 billion dollars in 1947. This would indicate that the reduction in 1947 for all business was about 2 billion dollars. We make the liberal estimate that it will continue at this level through 1952 though we might be justified in assuming that the end would come sooner.

Senator CONNALLY. Mr. Chairman, may I ask a question at that point?

ie) CHAIRMAN. Surely.

Senator CONNALLY. As a matter of fact, these were liquid assets owned by the corporations?

Mr. MITCHELL. That is right; which they accumulated during the war.

Senator CONNALLY. They accumulated these assets during the war?

Mr. MITCHELL. That is right.

Senator CONNALLY. And then in 1946, after the war was over, they put a lot of them into expansion?

Mr. MITCHELL. That is right.

Senator CONNALLY. So it does not recommend a loss at all; it simply recommends that they are prospering and doing well and taking a chance on increasing their plants?

Mr. MITCHELL. That is right, and the point we are making is that that source is being dried up quicker than had been expected because of the size and rate of growth of our present economy.

Senator CONNALLY. The reason they accumulated so much during the war was they probably could not use it in their normal activities.

Mr. MITCHELL. That is true. If it had not been for the war, that would have been used up previously. That is true.

Senator CONNALLY. There is nothing unusual about that, is there?

Mr. MITCHELL. We are not claiming here is anything unusual. We want to show there is one piece of capital funds available at the moment and it is going to be used up pretty soon, and there will not be any more.

That is all we are trying to show in that connection.

Commercial bank loans: Line 5 shows capital available from commercial bank loans. Commercial banks provide capital for private purposes in the forms of both business loans and residential mortgages. There has been a rapid rise in such loans during the past 2 years. The increases in 1946 and 1947 of all commercial bank loans are shown in columns (a) and (b). This trend has caused considerable alarm due to its effects on the money supply and intensification of the inflation problem.

The expansion of bank loans cannot continue indefinitely. In projecting our figures, we assumed that the annual amounts will decline from their present level, but nevertheless will continue to be substantial for the next few years. Our estimate of about \$4,000,000,000 annually from this source probably is more than is desirable, and hence is on the liberal side.

The CHAIRMAN. Bank loans obviously are intended to be safe loans? Mr. MITCHELL. They are, sir.

The CHAIRMAN. And therefore they do not touch the field of risk capital.

Mr. MITCHELL. That is right. The unfortunate part of it is that too many businesses have had to borrow from banks and use the money for purposes they should have been able to get venture capital for.

The CHAIRMAN. But it has put a lot of inflexibility into the business structure.

Mr. MITCHELL. That is right, and if we have a recession--

The CHAIRMAN. Will destroy by that token the equities already in the business?

Mr. MITCHELL. You are exactly right, sir.

Government subsidies, as shown in line 6, about \$1,000,000,000 in capital is provided each year from Government subsidies, mainly to farmers for improvements to their property. We assume that no great expansion of this amount will occur in the future.

Financing through institutions:

Line 7 shows capital available from private institutions, which mainly are savings banks, life insurance companies, and savings and loan associations. These institutions provide capital by purchasing mortgages or corporate bonds. They are not permitted to provide equity capital.

Senator LUCAS. Would you suggest that they should be?

Mr. MITCHELL. No, sir, by no means.

Although such institutions are now providing large amounts to private industry, this is not a satisfactory substitute for equity financing. It means heavy debt loads and heavy fixed charges which in turn can mean double trouble when the going gets tough for a company, an industry, or all business. However, and again this may be on the liberal side, we assume that institutions will continue to supply capital at about the present rate of \$8,000,000,000 annually.

There is, of course, need for investment capital continuously in business as well as for venture capital and that is one of the sources of the continuing need for investment capital.

The CHAIRMAN. That is the contribution as far as savings are concerned of the people in the lower brackets?

Mr. MITCHELL. That is right, That is where they should make their contributions.

The **CHAIRMAN**. And they do.

Mr. MITCHELL. They do. They make them whenever they buy a life insurance policy, whenever they put money in the savings bank, and so forth.

Venture funds provided by individuals: The full impact of present tax rates on venture savings is shown in lines 9 and 10.

No better evidence is needed of how difficult it is, under present tax rates, for the little businesses to grow and expand and compete with the old and established corporations.

That is perpetuating the big companies. That is not what has made this country great. We must have new capital, venture capital, that can be put into new enterprises.

Line 9 shows that individual investments in their own businesses totaled only \$2,000,000,000 in 1946 and \$3,000,000,000 in 1947. This total may, without benefit of tax changes, grow very slowly over the next few years due to the growth of the national income. We estimate that the \$3,000,000,000 rate will continue over the next 5 years, but that by 1953 the total may approximate \$4,000,000,000 a year.

The situation is even worse as to net new investment in corporate securities. As shown in line 10, individuals did not increase their holdings of corporate securities in either 1946 or 1947 (SEC data). No change can be anticipated in this situation until tax rates are moderated.

This does not mean, gentlemen, that nobody bought any stock in 1947. What it means is that there was no net increase in the amount held by individuals. If they bought some new stocks, they sold some old which were probably picked up by institutions, and it was more likely of investment.

Senator **JOHNSON**. Were there any new issues?

Mr. MITCHELL. Yes, sir, of course, but no net gain in the holdings by individuals, according to the Securities and Exchange Commission.

Senator **JOHNSON**. How could there be new issues and no gain?

Mr. MITCHELL. It is only those held by individuals, Senator, that I am speaking of, and I believe that to be a true fact. Institutions probably picked up and held what were sold by the individuals.

Senator **JOHNSON**. I do not see the importance of distinction between institutions and individuals. They are made up of individuals.

Mr. MITCHELL. The point I am trying to make is that there is so little money left over in the brackets of the people who generally put up the money for securities that they cannot add to their pile.

There is not any money. If they buy some new they have got to sell some old, because they do not have anything left over after their taxes.

Internal savings of business: Lines 11 and 12 show the amounts available from internal savings of business. The amounts retained by business for capital purposes are divided on their books between retained earnings and capital consumption allowances: depreciation and so forth. Profits due to inventory valuation, as estimated by the Department of Commerce, are eliminated from retained earnings, as the capital required for financing such rises in valuation are not included in the total capital needed.

While there probably will be a gradual rise in the allowances for **capital consumption, due to** replacement of present assets with new ones bought at a higher price level, this increase will be at the expense of **profits and** not materially affect the total of the two sources.

We assume that the total internal gross savings of business will increase in proportion to the **3.8** percent annual increase in gross product. No provision is made for an increase in the percentage of earnings paid out in dividends, although this percentage is now abnormally low and can be expected to increase over **the next** few years. Thus, our estimates of **\$19,000,000,000** annually in the next **5** years from this source, and **\$24,00,000,000** thereafter, may again be too high and hence too liberal.

The **CHAIRMAN, Mr. Mitchell.**

Mr. MITCHELL. Yes, sir.

The **CHAIRMAN.** Are you sure of your assumption:

We assume that the total **internal** gross savings of business will increase in proportion to the **3.8** percent annual increase in gross product.

Mr. MITCHELL. I think it is a reasonable assumption, Senator.

The **CHAIRMAN.** But do they have an analogy?

Mr. MITCHELL. They have a relationship, and we are using it purely as an assumption. There is nothing magic about the **3.8** figure, but we know for **60** years we had a healthy economy and did grow at about that rate.

The **CHAIRMAN.** Did you grow on both branches at that rate? Did the **gross** savings of business increase **3.8** percent while the general annual income was increasing **3.8**?

Mr. MITCHELL. Can you answer that, **George**?

Mr. HAGEDORN. In the **long** term, yes; as far as the fluctuations of the business cycle, no. In other words, as you go down the business scale, earnings decrease much faster than the general national income, and as you go up, earnings increase much faster than the national income.

The **CHAIRMAN.** This assumption, then, is supported by experience?

Mr. HAGEDORN. Yes, sir.

Mr. MITCHELL. Summary of table: Line 13 summarizes the total capital available from the indicated sources. Line 14 shows the annual capital deficit in the years **1948** through **1954**, which is derived by subtracting the total capital available, shown in line 13, from total capital requirements, shown in line 3. You will note that on the basis of these data, there will be an average annual deficit of some **\$8,000,000,000** for the 5-year period **1948-52**, and of **\$7,000,000,000** in each of the years **1953 and 1954—again**, assuming that present tax laws are not changed.

In his state of the Union message, the President said that industry would need to provide at least **\$50,000,000,000** for new investment over the next few years in order to be in position to supply the demands of consumers. Our projections show that the funds in sight indicate an annual deficiency of **\$7,000,000,000** to **\$8,000,000,000** a year, or an aggregate deficiency of upward of **\$50,000,000,000** during the next **6** to **7** years. It is gratifying to find that our estimates are so closely borne out by those of the President.

The **CHAIRMAN.** Is that all types of investment?

Mr. MITCHELL. Yes, sir.

Notwithstanding the President's forecast as to capital needs, the Secretary of Commerce undertook to demonstrate, before the Ways and Means Committee, that business is now able to meet its financial needs. The implication of this testimony was that business would be able to do so, even with an increase of the taxes on corporate profits. I hope that you will consider that data I have presented completely refute Mr. Harriman's statement.

We believe that our estimates and projections are sound and do not exaggerate the situation. We are convinced that these data constitute evidence of a grave deficiency in the volume of capital funds-funds that will be required in the years ahead to keep the economy operating at high levels of production, employment, and income. In our view they offer a challenge to fiscal statesmanship.

Since the funds for capital formation must come out of current income, it is clear that more of that income must be released, through a revision of the tax laws, for capital formation purposes. Saving and investment occur throughout the income scale, but it is beyond question that the bulk of the funds needed must come from the middle and larger incomes, and from a reduction of the corporation taxes.

In order to come within striking distance of the goal of an additional \$7,000,000,000 to \$8,000,000,000 for capital purposes, it is evident that there must be drastic revision of the tax rates on both individual and corporate incomes. In testifying for NAM before the Ways and Means Committee last July on the general subject of tax revision, I stated that the NAM program gave first priority, in this revision, to the individual income tax. Our reasons for this preference are:

1. It is the only way by which small, unincorporated business can get tax relief and can have adequate funds for reinvestment;

2. It is the only way by which individuals can be enabled to save out of current income for investment purposes;

3. It is the only way by which to give reality to a reduction of the corporation tax. Distribution of larger dividends, while present tax rates remain, would simply mean heavier tax payments rather than appreciably greater opportunity for saving and investment.

The NAM program of individual income-tax revision proposed a new rate scale, starting at 12 percent on the first \$2,000 of taxable income and rising to a maximum rate of 50 percent on taxable income of \$100,000 and above. This was presented as a first step, and still further reductions were said to be necessary at a not distant date. If we are to take seriously the Nation's capital requirements, then we must accept, as part of any program of tax revision, the substantial reduction of the tax rates through the middle and upper income ranges.

Senator CONNALLY. Let me ask a question there.

Mr. MITCHELL. Yes, sir.

Senator CONNALLY. By 12 percent, do you mean the amount of reduction or the amount of tax?

Mr. MITCHELL. That is the first bracket.

Senator CONNALLY. All right.

Mr. MITCHELL. In fact, we cannot delay much longer going further than this—which means facing the necessity for a substantial reduction of the corporation income-tax rate. There is not enough taxable income in the individual surtax brackets from \$18,000 up to fill the

capital formation gap if it were completely exempted from taxation and were all to be saved and invested. If that gap is to be filled, there must be a reduction of both forms of the income tax.

The CHAIRMAN. If you reduce your maximum rates to a level of not more than 50 percent, what difference would it make in revenue?

Mr. MITCHELL. I have a table here which shows that. I take it you are talking about the 12- to 50-percent plan.

The CHAIRMAN. No. Assume tomorrow we took existing law and merely reformed it sufficiently so that no one would pay more than 50 percent, what would be the loss of revenue?

Mr. MITCHELL. Without the community-property provision?

The CHAIRMAN. Just as it stands now.

Mr. MITCHELL. I think we have the figures here, but we do not have them put down.

The CHAIRMAN. A relatively small amount?

Mr. MITCHELL. Yes, sir.

The CHAIRMAN. The total receipts from the highest brackets are just relatively a small amount?

Mr. LUTZ. Three or four hundred million from the net income bracket over \$200,000 annually.

The CHAIRMAN. Let us assume for discussion's sake that is desirable. It would not remedy any of our crucial problems?

Mr. LUTZ. No, sir; not of itself.

Senator LUCAS. Let me ask right there: Taking your statement of 12 percent on the first \$2,000 of taxable income and arriving to a maximum rate of 50 percent on taxable income of \$100,000 and above what would be the total amount if you put that rate into effect?

Mr. MITCHELL. The total amount of reduction of revenue because of that?

Senator LUCAS. Yes.

Mr. MITCHELL. With or without community property?

Senator LUCAS. Without it.

Mr. MITCHELL. I have that figure. Approximately \$7,500,000,000 at the present income level.

The CHAIRMAN. You mean reduced that amount?

Mr. MITCHELL. It will reduce your revenue by \$7,500,000,000 as against the 6.6 billion that the present 4790 would.

The CHAIRMAN. How would it reduce the distribution of the remaining revenue as between the taxpayers having less than \$5,000 income and those having more than \$5,000 income?

Mr. DAVIDSON. It would maintain approximately the present distribution of the tax load.

Mr. MITCHELL. In other words, it would be almost equal percentage revision down the scale. It would give almost the same percentage reduction at the high-income brackets as it does in the low.

The CHAIRMAN. I am not talking about that. I am talking about the dollar amount of distribution to those having less than \$5,000 as contrasted to those having more than \$5,000 income.

Let me put it this way: I am testing how much, if any, burden you are shifting from the middle and upper income brackets to the lower brackets.

Mr. LUTZ. \$4,000,000,000, or somewhat more, would go to net incomes under \$5,000, and the remainder of the total amount would go to incomes over \$5,000.

The CHAIRMAN. That is about 4 out of 7; about the present ratio of distribution?

Mr. LUTZ. That is right.

Senator LUCAS. **Mr. Chairman,** may I ask a question there?

The CHAIRMAN. Yes.

Senator LUCAS. **Mr. Mitchell,** are you recommending to the committee that we incorporate into a tax program this formula that you laid down here, to reduce from the Treasury receipts \$7,500,000,000 from the corporate taxes?

Mr. MITCHELL. We started out asking for that a year ago. As I said earlier in my testimony, we believe that 4790 as passed by the House is the best bill that we can get at the present time.

Senator LUCAS. You would take that, if you could get it?

Mr. MITCHELL. You are quite right, sir.

Senator LUCAS. And you would include in addition to this the increase of personal exemptions plus the community property tax, too?

Mr. MITCHELL. That would cost-

Senator LUCAS. I know what it would cost. I am asking whether you would include that in your tax program also.

Mr. MITCHELL. We did not, in our tax program, include the \$100 increase in exemptions, Senator, and we think, although it is politically a pretty hard thing to sell the country, the economic interests of the country would probably be better served to reduce the upper-income brackets and forego temporarily the \$100 increase in exemptions.

Senator LUCAS. If I understand you correctly, if the National Association of Manufacturers had their way about a tax program, you would take the formula laid down here in your manuscript, giving the corporations a reduction of \$7,500,000,000, and stop right there.

Mr. MITCHELL. Yes, sir; but please understand that the reduction would go to individuals. We would go back to our original recommendation, which is a 12-to-50-rate scale on the individual income taxes, with no change in exemptions at the present time; the granting of a \$500 deduction for premiums paid on life insurances on the taxpayer's own life, and the removal of the 5-percent limitation on the medical expense deduction.

Senator LUCAS. Would it make any difference to you if that \$7,500,000,000 would cause the Government to go into deficit financing in order to run the Government?

Mr. MITCHELL. We do not think they ought to go into deficit financing.

Senator LUCAS. I say, would it make any difference to you if that could be proven; that the \$7,500,000,000 might make them go into deficit financing?

Mr. MITCHELL. Yes, it would.

Senator LUCAS. And you would change your formula and not ask so much?

Mr. MITCHELL. That is right. We think there is room for it, however.

Senator LUCAS. You think the Congress ought to lay down some rule whereby annually we would pay a certain amount on the national debt?

Mr. MITCHELL. Yes, sir. We are on record that we ought to pay \$2,500,000,000 on the national debt during every year.

Senator LUCAS. Do you take that into consideration when you make the recommendation of \$7,500,000,000?

Mr. MITCHELL. Yes, sir. We believe there is \$10,000,000,000 difference between what you are going to have to spend and what you get.

Senator LUCAS. You have been talking to Mr. Hanes, too?

Mr. MITCHELL. No, sir; I have not. But I read his testimony before this committee.

The CHAIRMAN. Mr. Mitchell, you are speaking about saving the economy of this country. I should like to suggest to you if you save the economy of the country, it will take a majority of the people to do it and their representatives here in Congress. Out of our 54,000,000, income-tax payers, 52,000,000 have incomes of less than \$5,000 a year.

Mr. MITCHELL. That is right, sir.

The CHAIRMAN. You have got to have very widespread popular approval and very widespread reflecting approval, therefore, in Congress, to pass any tax law.

Mr. MITCHELL. I agree with you.

The CHAIRMAN. It is not a strict exercise in logic.

Mr. MITCHELL. I agree with you, sir, and that is why I am making the testimony today on the basis I am instead of going back to the bill we proposed to the House Ways and Means Committee.

The CHAIRMAN. If the House Ways and Means Committee reductions were reduced some more, you might not like it, but I assume that would be acceptable to you?

Mr. MITCHELL. My personal opinion is, Senator, it is important to take a step in the correct direction. It is always easier to take a second step if you have got the first one back of you.

The CHAIRMAN. I agree with that.

Senator CONNALLY. In other words, your present desire to come down a little in this is predicated on "We will get this much now, but just a little later we will get some more"?

Mr. MITCHELL. I do hope so.

Senator CONNALLY. Is that not your purpose?

Mr. MITCHELL. My purpose is to get this one.

Senator CONNALLY. And then you said the advantage would be it is a step in the right direction?

Mr. MITCHELL. Yes, sir.

Senator CONNALLY. As soon as you get this, you will come along and try to get some more.

Mr. MITCHELL. I am certainly going to try to get this deficit in venture capital made up so we can go ahead on a sound basis.

Senator CONNALLY. This country is going backward awfully fast financially.

Mr. MITCHELL. I am not worried about 1947. It is a pretty good year; but my crystal ball cannot tell me what is going to happen in 1948 and 1949.

Senator CONNALLY. \$200,000,000,000 national income, a great deal of which your crowd got—the manufacturers.

Mr. MITCHELL. I do not know who is my "crowd."

Senator CONNALLY. You say you represent the manufacturers. You say you represent the National Association of Manufacturers; do you not?

Mr. MITCHELL. I presume the manufacturers of the country got a great deal of that \$200,000,000,000.

Senator CONNALLY. You know whether they did or not. You have got all sorts of tables and statistics there.

Mr. MITCHELL. I do not think they got it all.

Senator CONNALLY. No; I do not think you did, either. I think you would if you could, but you did not do it.

Mr. MITCHELL. You do not mind if I disagree with you, Senator? Senator CONNALLY. No; and you do not mind if I disagree with you?

Mr. MITCHELL. No.

Senator CONNALLY. I want the manufacturers to get something. I want business to grow and develop along with our economy, of course, but all this wild cry about disaster; those cries do not appeal to me because we are doing pretty well.

Mr. MITCHELL. Senator, our difference is I am trying to look into the future. I would like this to keep up. I rather like the way the country is doing businesswise, and I would not like it to stop.

Senator CONNALLY. That is right.

Mr. MITCHELL. I am afraid if we do not fill this capital need in the future, you are liable to come against a time you will not be doing so well.

The CHAIRMAN. What percentage of what you fellows get goes to pay roll? I do not know if I have the national figures, but I

would be happy to tell you about my own company, sir.

We do \$95,000,000 worth of business and our pay roll and employee benefits are \$40,000,000 of the \$95,000,000.

The CHAIRMAN. What is the national over-all percentage of pay roll to the national income?

Mr. HAGEDORN. Senator, if you take the national income without any fluctuations, you will find the payments to hired employees are about 75 or 80 percent and have been from time immemorial. That percentage has not changed at all in historical period.

If you take the record of private business and include the total receipts of business, you will find the pay roll is just about half, and remains very close to that point through all different economic periods.

Out of the remaining half, business has to pay its taxes, provide for replacement of its capital, and whatever is left after those is its profit.

The CHAIRMAN. What is the historic percentage of profit?

Mr. HAGEDORN. I have some figures here, Senator, on the percentage distribution of private national income from 1929 to 1947. They are by the Department of Commerce.

Of course, in that 18-year period, we had some rather violent economic fluctuations.

The Department of Commerce says that the 1947 corporate profits after taxes took 9.4 percent of the total private national income.

In 1929, it took 10.1 percent. Of course, during the depression it became very small.

The CHAIRMAN. Is that after taxes?

Mr. HAGEDORN. That is after taxes.

During the depression it became very small. In fact, in 1931-32-33, it was a negative item.

Since 1939, I will read off the figures: 7.7 percent in 1939; 8.8 percent in 1940; 9.9 percent in 1941; 7.8 percent in 1942; 7.3 percent in 1943; 6.6 percent in 1944; 6.1 percent in 1945; 8 percent in 1946; 9.4 percent in 1947.

The CHAIRMAN. Thank you very much.

Senator MARTIN. May I ask a question there, Mr. Chairman?

The CHAIRMAN. Yes.

Senator MARTIN. In that percentage paid out in wages, does that include the white-collar salaries and executive salaries, or just what we commonly know as labor?

Mr. HAGEDORN. It includes all wages and salaries.

Senator MARTIN. Includes executive?

Mr. HAGEDORN. That is right.

Senator MARTIN. What proportion of it is for, we will say, the administrative end; that is, the white-collared class and executive?

Mr. HAGEDORN. I cannot say offhand, Senator.

The CHAIRMAN. Proceed, please, Mr. Mitchell.

Mr. MITCHELL. First the subject can be reduced to a level that will make possible a degree of tax reduction under which the funds needed for capital formation can be provided. I am sure that all of us can agree that this is the ideal way to get the job done. I am sure that this committee, or the Congress as a whole, will agree that the ideal is realizable at this time.

Senator LUCAS. Right on that point: How do you figure the budget ought to be reduced?

Mr. MITCHELL. That is a difficult question. The National Association of Manufacturers has made a study, sir, and on the basis of the facts before us, we believe the budget could be cut to \$33,000,000,000.

Senator LUCAS. That would be some \$6,000,000,000 plus. You have got facts and figures to substantiate that?

Mr. MITCHELL. Yes, sir. We would be happy to supply each of you with complete detailed facts.

Senator LUCAS. Instead of testifying on this tax bill, you should have appeared before the Budget Committee.

Mr. MITCHELL. We would be very happy to supply you with our reasoning. It is a complete and detailed study, Senator.

Senator LUCAS. I think that ought to go to the Appropriations Committee, because that is an important statement to make.

If you could show how to reduce the budget \$6,000,000,000, I am sure the Congress would be very grateful to you.

Mr. MITCHELL. I would be happy to do so, sir.

(The information will be found on p. 601.)

Second, if we assume that an across-the-board reduction of the budget is not now possible, there can still be a budget cut by sacrificing the nonessentials because of the urgency of certain essentials. For example, if the requirements of foreign aid and defense have top priority in the budget, then there should be drastic belt tightening in other parts of the budget.

We suggest, for instance, public works.

Senator LUCAS. You come here with an assertion of that kind, without any break-down, and just a general conclusion. It does not mean a thing to me.

When you make a statement that the budget ought to be reduced over \$6,000,000,000, you ought to have figures to substantiate it.

Mr. MITCHELL. The statement we are making here does not call for—

Senator **LUCAS.** You are telling the Finance Committee exactly what ought to be done with the budget.

Mr. MITCHELL. I have told you, sir, we have a break-down of that budget we will be glad to supply you. So it is not just an out-and-out assertion.

Senator **LUCAS.** You are talking about if national defense cannot be sacrificed, there ought to be belt tightening in other parts of the budget. You ought to have some figures to show what you mean by that statement, because, standing alone, it is worthless.

Mr. MITCHELL. The reason we do not have it, we are not depending on that for this thing we are asking for.

Senator **LUCAS.** You should not make a statement unless you depend upon it.

Mr. MITCHELL. Very well, sir.

Senator **MARTIN.** Mr. Chairman, I think in fairness to the witness, as I understood, you do have those figures that you could present?

Mr. MITCHELL. Yes, sir, and have offered them to the Senator.

Senator **MARTIN.** And I think that it is not quite fair of my distinguished friend from Illinois, not quite fair to the witness to leave him in that position.

I think if there is any doubt as to his figures, he ought to be permitted to present them here, although they ought to go before the Appropriations Committee.

The **CHAIRMAN.** Those figures have direct relevance on what we are doing here, and we will certainly be glad to have them here. I am sure Appropriations would also be glad to have them.

Mr. MITCHELL. Thank you, sir.

Senator **BARKLEY.** Does that mean you are going to tell us how much you think ought to be sliced off the budget for Public Works?

Mr. MITCHELL. We have a total for Public Works; yes, sir.

Senator **BARKLEY.** Do you know the total?

Mr. LUTZ. In the fiscal year 1949, the total for civic public works, Senator, is \$2,859,000,000.

Senator **BARKLEY.** Will you tell us how much of that ought to be cut off?

Mr. LUTZ. That is the total in the fiscal year 1949.

Senator **BARKLEY.** The total estimated by the Budget?

Mr. LUTZ. That is in the Budget estimate; yes, sir.

Senator **BARKLEY.** You do not know how much Congress will appropriate?

Senator **TAFT.** I recollect that it is about a 50-percent increase over expenditure for public works in the current fiscal year.

Mr. LUTZ. One hundred percent over 1947.

Senator **TAFT.** That is what I meant.

Senator **BARKLEY.** Those expenditures and appropriations for public works are not required to be spent in the year appropriated. They run on until usually completed, and they are not bound by a particular date.

I am interested to know how much of this public works you would cut off, and what part of it, and what items.

Mr. MITCHELL. Dr. Lutz made the study, sir, and perhaps he can say.

Senator **BARKLEY**. And what projects you would eliminate.

Mr. **LUTZ**. This particular study was not as to the detail of projects. We simply pointed out in view of the inflation situation and scarcity of labor and materials, and in view of the stop-spend order of 1946, on the grounds that then the taxpayer was not getting a fair value, it was reasonable to assume in 1949 there could be no case for spending more than actually was spent in fiscal 1947, which was \$1,400,000,000, or half as much as the budget for 1949 proposes.

Senator **BARKLEY**. All right.

Mr. **MITCHELL**. Right here, we should take note of the fact that many of those committed to the present level of Government spending place the greatest emphasis on, or perhaps hide behind, the necessity for adequate defense and maintaining our international position.

Senator **CONNALLY**. By "perhaps hide behind," you mean to impugn their motives, do you not?

You are high-minded and honest when you want to cut taxes, but a man that does not is a crook. Is that correct?

Mr. **MITCHELL**. I would not go so far as to say that, Senator, but it is always easy to spend more money in government and hard to spend less.

Senator **CONNALLY**. You mean by that language to impugn the motives of those who do not agree with you on reducing taxes?

Mr. **MITCHELL**. No, I would not say-

Senator **CONNALLY**. What else do you mean, then—"hide behind?" In other words, the sheriff is looking for them and they are out in the brush somewhere hiding.

Mr. **MITCHELL**. We will cut out the words "perhaps hide behind," Senator.

Senator **CONNALLY**. I do not want you to cut them out. They represent your views.

Mr. **MITCHELL**. That is right.

Senator **HAWKES**. I think, Mr. Chairman the witness might have used a better expression: "Because of political expediency and pressure groups and demands, many of those in the Congress would rather comply with those demands from the voters in their particular district than to take the right course in preserving the United States of America."

Mr. **MITCHELL**. I will accept your statement, Senator.

Senator **BARKLEY**. I do not want to pursue this thought, but you were it seems to me, very unfortunate in using the words "hide behind" in connection with our national defense.

Are you willing to identify anybody who is urging national defense who is hiding behind it?

Mr. **MITCHELL**. No, not at all. My next statement says that I would be the last one to quarrel with these objectives.

Senator **BARKLEY**. You would be the last one, but you are among those who do.

Mr. **MITCHELL**. I do, however, strongly want to make the next statement, Senator, that we must constantly remind ourselves that we have no military strength, we have no international prestige and influence, except for the strength of our domestic economy.

In other words, if our domestic economy is weak, we cannot have military strength and international prestige and influence over the

long period, and my plea is to keep our domestic economy strong so we can have all these things.

Senator BARKLEY. You do not think it is weak now, do you?

Mr. MITCHELL. No; but I am afraid it might get weak.

Senator BARKLEY. I am sorry that I got in a little late and missed a part of your statement. But have you identified any figure by which you would reduce the Treasury's income by reduction of taxes?

Mr. MITCHELL. My plea is to have the Senate pass the Knutson bill, 4790, in its present form, which is \$6,600,000,000.

Senator BARKLEY. You think that would strengthen us?

Mr. MITCHELL. I think it will help to, sir.

The CHAIRMAN. It has been indicated to the witness, Senator Barkley, that it might be less, and that would be reluctantly acceptable.

Senator BARKLEY. On his part?

The CHAIRMAN. Yes.

Senator BARKLEY. All right.

Mr. MITCHELL. This simply means that if we recognize the needs for replenishing our capital sources, then we must also recognize that tax reduction of the right kind and in full amount is needed to maintain our strength abroad as well as at home.

Or, to put it in terms of the budget, if first things come first we need not spend in 1949 twice as much on public works as was spent in 1947. Nor do we need to embark on new and costly programs, and certainly we do not need to spend as much on some of the existing programs of dubious worth and low priorities when the whole national interest is considered.

Here, I refer, gentlemen, to some of the Government bureaus that were established as depression-fighting bureaus and are still there.

What was it the fellow said—the nearest thing to immortality on earth is a government bureau?

Senator LUCAS. I think the National Association of Manufacturers is closer to immortality.

Mr. MITCHELL. You do not mind if I disagree with you, Senator.

Third, we as a Nation may need to moderate our views on the importance of a large budget surplus for debt reduction as compared with tax reduction at the present time. The NAM has been a strong advocate of debt reduction, recommending \$2,500,000,000 as an annual minimum for this purpose. The Congress has just gone on record, in the legislative budget, for setting aside \$2,600,000,000 for this purpose. These are realistic and reasonable positions if we do not go further and insist on an additional safety margin in the budget to meet these goals. At the present time, we cannot afford to maintain tax rates that anticipate an extra amount of surplus in the administrative budget for debt payment at the expense of supplying the economy with more of the lifeblood of new capital. We find added strength for this view in the fact that the marketable debt in the hands of the public is being reduced at a substantial rate through the application of the cash surpluses which are being created by other parts of the Federal fiscal system.

There may still be other approaches to a solution of the tax problem. Nothing can be more certain, however, than that there must be a solution if our national economy is to grow and become stronger. It is not a matter of tax reduction versus debt retirement or a strong

military. We just won't have debt retirement for long, and we won't have the economic strength to back up a strong military, unless something drastic is done about present tax laws.

A hundred years ago **Karl Marx**, in his **Communist Manifesto**, gave the graduated income tax second place among the important steps for destroying the system of **free capitalism**. Today, the last great bulwark of free **capitalism** in the world is **undermining** its strength with a tax system that could not have been better conceived in the Politburo. We shall be inviting all the disaster that **Karl Marx intended** for us if we make plans for powerful industrial support of a powerful defense **establishment** while continuing to employ a tax system which will bleed our free economy white.

The **CHAIRMAN**. Any questions?

Senator **BARKLEY**. Do you mean that you are opposed to the graduated system of income taxes, or that the National Association of Manufacturers opposes it?

Mr. **MITCHELL**. What **Karl Marx** said was that the graduated income-tax system once installed keeps getting higher and higher and higher and sometimes goes on until it finally gets so high it dries up the sources of capital.

Senator **BARKLEY**. It is not the system, then, it is the rate?

Mr. **MITCHELL**. It is the rate.

Senator **BARKLEY**. Of course, **Karl Marx** said that 100 years ago, and at the rate of debt reduction you recommend, it would be another 100 years before we pay this debt off.

You have calculated that, I suppose: At $2\frac{1}{2}$ billion, it would take 100 years to pay that off.

Mr. **MITCHELL**. That is right.

Senator **BARKLEY**. And that would discount the possibility of having to increase it or go further into debt on account of an emergency?

Mr. **MITCHELL**. Yes, sir.

Senator **BARKLEY**. How long would it take if we had these recurring emergencies to get to the point where the country would have to repudiate its debt because of the impossibility of payment?

Mr. **MITCHELL**. I have not any idea.

Senator **BARKLEY**. Such a thing might be possible?

Mr. **MITCHELL**. Yes.

Senator **BARKLEY**. And if we do not pay this debt while we have a lot of money with which to pay it, we cannot do it when we subside, or retrace our steps, or go backward in the matter of income in this country from which most of our revenue must be derived.

It seems to me it is a short-sighted policy to fix a debt-retirement rate that will take a whole century to get rid of the debt we have now.

Mr. **MITCHELL**. Senator we are not in disagreement except to this point: There must be a balance to this thing. If you do not put enough capital into the system to keep the economy going, what good is it going to do you to make one payment this year and another big one next year, and then 2 or 3 years later have to go into deficit financing?

Senator **BARKLEY**. That is what I fear in regard to your tax-reduction program; that is, we are going to have that happen in 2 years if we reduce the income so much we cannot pay any on our debt, and we might have to go into deficit spending.

I hope we will not, but if an emergency arose, we would have to increase that debt beyond what it has been, even beyond what it was at the end of the war.

Mr. MITCHELL. We feel, Senator, by giving some tax relief, especially in the middle and upper brackets, there will be money available for the creation of new jobs and new capital plant which will help to sustain this level of economy rather than have the slump you are talking about.

Senator BARKLEY. Everybody that wants a job in this country has got one now.

Mr. MITCHELL. There is no argument about that today.

Senator BARKLEY. You do not have to create an immediate incentive to get more jobs because anybody can get a job who wants one now.

I do not know how long it will last. I hope a long time.

Mr. MITCHELL. I do, too.

Senator BARKLEY. There is no way to predict it.

What I am worried about is the longevity of this debt and the future generations yet unborn may have to pay it.

Mr. MITCHELL. We are all worried about it.

Senator BARKLEY. That they are going to have this thing settled on them, and they will not be in any position to meet an emergency that might arise in their generation.

Mr. MITCHELL. What I am trying to say, and I think you are saying, we have got to find some balance between them.

Senator BARKLEY. That is all.

The CHAIRMAN. Any questions?

Senator MARTIN. How much do you think we can reduce the debt without the danger of deflation?

Mr. MITCHELL. We have recommended an annual debt reduction of 2½ billion dollars.

Senator TAFT. You say "not less than"?

Mr. MITCHELL. Not less than. Probably beyond that.

Senator MARTIN. How much could we reduce it without the danger of deflation?

Mr. MITCHELL. Of course, if you used all of it to replace bank-held debt you would have a pretty deflationary influence. If you went far beyond that figure, it might be quite deflationary.

Senator BARKLEY. Will you explain the mechanics of that sort of deflation? I am not committed to paying off the bank part of the debt before paying off the other people.

A lot of people bought bonds and are holding them who are not in the banking business, and I do not feel like saying only the banks ought to be paid off if the debt is to be reduced.

If you paid \$5,000,000,000, we will say, to banks, and took up the bonds they hold, that money would go into their capital.

Mr. MITCHELL. Come out of their deposits.

Senator BARKLEY. How is that?

Mr. MITCHELL. It would come out of their deposits.

Senator BARKLEY. Not necessarily. It would come out of the Treasury of the United States to pay off the bonds held by the banks.

That money would be either owned by the banks when they got it back, or put on deposit in the banks. How is that deflationary?

Mr. MITCHELL. Do you mind if I defer that question to Dr. Lutz, sir?

Senator **BARKLEY**. You answered Senator Martin's question on it, and I wondered if you could not explain it.

Mr. **MITCHELL**. You might get me over my head in that financial situation.

Senator **TAFT**. We have quite an argument going on between our Joint Economic Committee and the President's advisers as to how deflationary payment of the debt is and is not.

Senator **BARKLEY**. If you pay off somebody holding Government bonds he has that money and spends it maybe. Presumably invests it or does something with it.

That is not deflationary. It might be inflationary insofar as prices are concerned. If he has more money he would buy what he needs. It might be inflationary, would it not?

Senator **TAFT**. May I suggest—

Senator **BARKLEY**. I would like for the witness to answer this question. He brought this up.

Mr. **MITCHELL**. I am going to defer it to Dr. Lutz.

The **CHAIRMAN**. Go ahead and tell us about it; Dr. Lutz.

Mr. **LUTZ**. Mr. Chairman, as Senator Taft says, the situation is extremely complicated.

Senator **BARKLEY**. As any Senator would say.

Mr. **LUTZ**. Any Senator; pardon me.

Suppose we begin with the kind of situation you apparently had in mind, Senator, in which the Government collects a thousand dollar from a taxpayer and turns the money over to another individual bondholder.

That is a transfer of money from the taxpayer to the bondholder. The taxpayer has a thousand dollars less to spend and the bondholder has a thousand dollars more to spend and there is no over-all change in aggregate purchasing power of the economy.

It is neither inflationary nor deflationary when the Government debt is redeemed in the hands of the general public.

Let us move another step over. Assume the Government is going to pay off debt held by the ordinary commercial bank.

In that case the taxpayer's check goes into the bank through the Treasury, and the Government picks up the thousand-dollar bond.

The result is the bank's assets are decreased by the thousand dollars and the bank's deposit liability decreased by the thousand dollars, and the net result of that is that the bank's own reserve position is somewhat improved, because the reserve which it carries with the Federal Reserve bank then bears a somewhat higher percentage to the remaining deposits than it did previously.

That may have deflationary consequences.

It depends—

The **CHAIRMAN**. That one threw a lot of people off as you went around that curve. Will you go through that second step again and demonstrate it, please? The Government now takes a bond from the bank—

Mr. **LUTZ**. The bank's total assets obviously are diminished because they have been carrying that as part of total assets.

The **CHAIRMAN**. It has cash instead of a bond. The Government picks up a bond and gives it cash.

Mr. LUTZ. But the taxpayer's deposit account, the check which he wrote to pay the taxes somewhere in the economy, is diminished by a thousand dollars.

The **CHAIRMAN.** What is the relation, though, of taking that bond out of the bank's circulating stream to the credit base of that bank in relation to Federal reserve?

Mr. LUTZ. The bank's own reserve position is improved, as I tried to explain a moment ago.

The **CHAIRMAN.** You mean it has a better position with cash than it did with the bond?

Mr. LUTZ. I mean it now has an additional thousand dollars in reserve account.

The **CHAIRMAN.** It has cash, but did it not have certain credit enhancing possibilities when it had the bond?

Mr. LUTZ. But it did not have the bonds in its own account as reserve.

Senator **TAFT.** Let us get it another way: In the first 3 months of this year, we are going to have a Government surplus of \$7,500,000,000. That means we take \$7,500,000,000 away from the taxpayers out of the deposits of the banks.

Mr. LUTZ. That is right.

Senator **TAFT.** And you thereby reduce bank deposits 7½ billion dollars?

Mr. LUTZ. That is right.

Senator **TAFT.** That is a very deflationary operation.

Now, if you take \$7,500,000,000 and pay off bonds in the hands of the Federal Reserve banks who hold about 22 billion of them, that is purely deflationary; is it not?

Mr. LUTZ. I was coming to that as a third step.

Senator **TAFT.** In that case you reduce the deposit and you just use the money up. You put it away, so to speak, by paying off Federal Reserve banks.

Now, however, supposing you pay off bonds in the hands of the banks. That puts cash back into the hands of the banks and improves their reserve position.

Mr. LUTZ. That is right.

Senator **TAFT.** Because before that they had bonds instead of that?

Mr. LUTZ. Right.

Senator **TAFT.** Now, then, if they turn around and lend that money again, you completely neutralize the deflationary effect; is that correct?

Mr. LUTZ. That is true.

Senator **TAFT.** Is not that exactly what happened in the year 1947, as a matter of fact? At least, that is what the President's report said, in effect, we have a surplus for calendar 1947 of about \$5,000,000,000 instead of \$7,000,000,000, and on the other hand, bank loans have increased about \$5,000,000,000.

Mr. LUTZ. That is right.

Senator **TAFT.** So the net effect of that thing is we are right back where we were when we started.

Mr. LUTZ. Of course, Senator, that does not have anything directly to do with the initial step we are talking about, which is the reduction of the bank-held debt.

If the bank is not willing to expand its loans, the results would be simply this improvement in their own reserve position. They are in a position to expand loans because of reserve holdings having increased.

Senator **TAFT**. I agree it does not make much difference as long as we maintain the price of Government bonds the banks have, which is an unlimited source of new reserves.

Mr. **LUTZ**. That is right.

Senator **TAFT**. They can sell bonds to the Government, and they all have about 50 percent of assets in bonds, and the Government has to buy as long as we maintain the price of Government bonds.

So, I suppose you are right, the reserve thing is no longer a check on bank loans.

Mr. **LUTZ**. That is right.

Senator **BARKLEY**. You look at every bank statement in the country published in the papers, and they give enormous amounts of Government bonds they hold.

I am not talking about the Federal Reserve banks.

Every bank in this country in its statement gives a certain amount—\$5,000,000; \$20,000,000; in some cases billions, these large banks.

That is their individual property in their vaults.

They do not loan that. That is a static amount they have there. So that does not create any inflation because they cannot loan those bonds, and they cannot do anything but hold them in the vaults or sell them.

So long as they hold the bonds and do not cash them, they do not increase their deposits or amount of money available for loans.

After all, even where they have bought the bonds, it represents a lot of other people's money in deposits, and it is a liability to their depositors although carried as an asset of the bank.

If they cash those bonds and get the money for them, they have that much more money available to loan to the public, and that would be inflationary rather than deflationary; would it not?

Mr. **LUTZ**. That is right. Just what I have been saying.

When the Government redeems a bond held by the bank, the bank then has that much more in the reserve account and is in position to go out and expand loans up to the legal percentage limitation against their reserve.

Senator **BARKLEY**. One reason the banks have invested so much money in these bonds is the amount of loans compared to their deposits in some cases have been infinitesimal and they had to invest it in something that would bring return.

Mr. **LUTZ**. The bank acquisition of bonds took place during the war, Senator.

Senator **BARKLEY**. I know, but if they had demands from people generally, or industries, they would not have invested all that money in bonds.

Mr. **LUTZ**. I am not sure they could have avoided that during the war.

Senator **BARKLEY**. They would have a certain amount, but the constant complaint we hear for several years is that banks did not have demand enough for loans in their particular communities to carry on a banking business in the ordinary sense of making money out of interest on loans they made.

Mr. LUTZ. That is right.

Senator BARKLEY. Now, that situation, of course, was accentuated during the war because the banks were patriotic as well as individuals and wanted to help the Government finance the war.

But it is also to be remembered that all these people who hold bonds, whether individuals or banks, hold a promise and obligation of the Government of the United States to pay that bond, and I cannot, myself, reconcile my theories to the belief that the Government ought to take advantage, or at least be evasive, on an obligation it has made to the people or the banks or anybody else, by postponing forever adequate payment on those combined obligations, and retire this debt within a reasonable length of time. Not too fast, but certainly I do not want to pass it on to the children who are going to be born 100 years from now in 2048, if I can help it.

The CHAIRMAN. Senator Taft?

Senator TAFT. Mr. Mitchell, I wanted to ask you another question. Your whole thesis is based on the assumption the only way to get capital is from the upper-income group?

MITCHELL. Venture capital.

Senator TAFT. Equity capital, yes.

There are two other things I wonder if your committee have explored first place, to what extent is a low capital-gains tax a sub-

stitute for incentive for investment to a rate decrease?

In other words, assuming the rates on higher income are not reduced or cannot, or whatever it may be, what other methods of providing incentive capital have you explored?

One I just suggested was a lower capital-gains rate which I should think might be some incentive.

Mr. MITCHELL. It is some incentive.

Senator TAFT. At least people can build up their capital. They cannot get much income from it, but they can build up their capital under those circumstances.

Mr. MITCHELL. That is perfectly true.

Senator TAFT. And spend capital if they wish instead of income.

Mr. MITCHELL. That is right.

Senator TAFT. Have you explored in any way the possibility of stimulating savings among the lower income groups in some way that would get that money invested in equities instead of in bonds?

Mr. MITCHELL. I have some question, Senator, in my own mind as to how much of the income of the lower group should be invested in equities.

I consider common stock of American Telephone and Telegraph as equity, and probably an investment, not a speculation.

Senator TAFT. I once introduced a bill to set up some kind of Government insurance like FHA, an investment company which would gather together small savings, and might, through Government insurance of 50 percent, perhaps, of equity, stimulate the gathering of savings together from the smaller-income people. Because just purely as a kind of realistic approach, I do not see the day when you are going to put back large fortunes again and have a lot of angels starting small companies.

Mr. MITCHELL. No.

Senator **TAFT**. That is your advocated theory, and even at 50 per cent-

Mr. **MITCHELL**. There have to be a lot more of smaller angels.

Senator **TAFT**. I wondered if, while you were studying these things, whether you might study alternatives for a lower rate.

The **CHAIRMAN**. Dr. Lutz, you demonstrated what happens when the Government buys a bond from the citizen, and what happens when the Government takes a broad out of the bank's portfolio.

What happens now when it takes it from the Federal Reserve?

Mr. **LUTZ**. That is the most deflationary procedure of all, Senator.

The redemption of bonds held by the Federal Reserve banks, by the use of taxpayers' money, means without any further step in the process, the reserve banks make the checks that are drawn against the balances of the member banks which are carried as a reserve with the Federal Reserve Bank, and you get the same leverage in compressing the available volume of credit reserves that you get when the Federal Reserve bank makes available more money for the expansion of bank deposits.

I would say, depending on the reserve percentage—as I remember it now something up to 22 percent—it would mean in the central reserve cities a contraction of something like 5 to 1 leverage downward in compression of credit.

The **CHAIRMAN**. Is it not the announced policy of the Treasury to retire the debt by taking bonds from the Federal Reserve?

Mr. **LUTZ**. Senator, I cannot answer that question directly, but it seems to me this whole matter of debt management is something that must be flexible. It would depend entirely upon the general business.

The **CHAIRMAN**. I understand. I am driving to the single point of what is the Treasury's policy.

Mr. **LUTZ**. I cannot answer that.

Senator **TAFT**. Under the present policy of the Treasury, the moment you reduce that reserve and thereby tighten up on the banks, the banks immediately proceed to sell their Government bonds and the reserve has to pay them under present Treasury policy. So you cannot reduce the amount of bonds held by the Federal Reserve bank as long as there is any desire on the part of the banks to lend money on them.

Mr. **LUTZ**. That is right. As long as you have a large pool of negotiable paper, as there is, you cannot prevent that transfer in either direction.

Senator **TAFT**. We propose to start hearings on the whole question of bank reserves and this business of maintaining Government bonds at par, keeping the rate of interest down, in April. So I hope you will come back and testify before us.

Senator **CONNALLY**. Mr. Chairman?

The **CHAIRMAN**. Senator Connally.

Senator **CONNALLY**. As I understand your testimony, you have stressed the desirability of getting more capital and increasing plants and so forth. Is that correct?

Mr. **MITCHELL**. Yes, sir.

Senator **CONNALLY**. We had some testimony here the other day as to the percentage of increase in 1947. Do you know what that was?

Mr. **MITCHELL**. No. I imagine it was sizable.

Senator **CONNALLY**. As I recall it **now**, it was 54 percent over the previous year. I have not looked at the hearings since.

That is pretty satisfactory progress, **is it not?**

Mr. **MITCHELL**. Yes. It is not that we are arguing about, Senator. Could I give you an example from my own **business**? I know that perhaps better than any other business.

Senator **CONNALLY**. All right.

Mr. **MITCHELL**. Here is a company that has grown. It is a little **company** if you think of the big giants; it is a large company if you think of little individual businesses.

It did about \$20,000,000 worth of business a year before the **war**.

In 1947, which is really the first full postwar year after reconversion, it did **\$95,000,000** worth of business.

Senator **CONNALLY**. That is pretty good, over **\$20,000,000** before the war.

Mr. **MITCHELL**. Very good. We have no complaints.

Senator **CONNALLY**. Nearly five times.

Mr. **MITCHELL**. That is right.

We have outstanding **1,000,000** shares of common stock, and **100,000** shares of preferred. It gives us about **\$30,000,000** of working capital. In our industry, it is historically a **2-for-1** industry.

That means it takes about a **dollar's** worth of capital to make \$2 worth of sales.

So, we could not swing \$95,000,000 worth of business with \$30,000,000 worth of capital.

What we should have done, sir, if equity capital had been available, is to go into the market and sell more common stock to broaden our base so we can have enough capital to swing **\$95,000,000**.

Another thing we could have done is refused to grow, I suppose, and keep it where it was.

What we did was what most other companies **did**. We went to the bank and borrowed \$14,000,000, which gives us about \$44,000,000 of working capital, and by turning it a little oftener than usual, we were able to swing \$95,000,000 worth of business.

As **long** as we can borrow bank money at 2 percent, which we are doing, **and** as long as we do not go any further, we are all right.

But those bank loans come due in 5 years. And supposing that we do not get a chance in the equity market to get any more capital in below at the base of that situation. Suppose equity does not become available. When the time comes, after this 5 years, the bank is going to want its \$14,000,000.

If we have not made profits enough to pay it **off**, the bank is going to own our business. That is not going to **happen** because we are going to find some way to sell long-term debentures to insurance companies, **or something** else, but the point is, it is conceivable bank credit could **dry up**

It is doing that rapidly now. It is getting harder and harder to borrow from banks and harder to sell debentures to insurance companies and there will come a time when only blue-chip companies can sell them to insurance companies at fair rates.

What we need to do is get more in the business.

Senator **CONNALLY**. What did you do with the profits you made on the **\$95,000,000**? Did you put them back into the business or spend them?

Mr. MITCHELL. I will **ten you** exactly what we **did**. We made \$2,500,000 after taxes, **which** is about 2 percent on our sales, a little better than **5 percent** on our capital, not enough money, not enough percentage. It is unhealthy. We could not keep business eventually on a basis of **2½ percent** on sales and 5 percent on capital. It is not enough.

We are going to try to better that by increasing our own efficiency. Senator **CONNALLY**. You did not tell me what you did with your profits.

Mr. MITCHELL. There is a little rule in the Internal Revenue Code, called section 102, that you have got to **pay out 70 percent** of that money in dividends or explain why you **did not**, and **we** paid out 72 percent of that **\$2,500,000** in dividends, and the rest of it, which is about **\$700,000**, **we** added to surplus.

And at **\$700,000**, it is going to take a lot of time to get that **\$14,000,000** if that is **all** we **are** going to **put** back in **the** business.

Senator **GEORGE**. That **will** be about as slow as paying off the national debt, will it **not**?

Mr. MITCHELL. Pretty near. It reminds me very much of it.

The **CHAIRMAN**. Any further **questions**?

Senator **LUCAS**. One other question.

You do not contend, Mr. Mitchell, there is very much venture capital in this tax **measure**?

Mr. MITCHELL. No, **sir**, there is not very much, but every little bit will

Senator **lp**. You understand that **71 percent** of this money, as

I recall, from the table, 71.62 percent goes to individuals who have an annual wage of \$5,000 or less.

Mr. MITCHELL. Yes, **sir**.

Senator **LUCAS**. There is not very much venture capital in that **group**.

Mr. MITCHELL. Not much; no, **sir**.

Senator **LUCAS**. Very little in the balance of it, the way it is distributed here.

Mr. MITCHELL. Yes.

Senator **LUCAS**. What you hope is when this tax measure is adopted, perhaps next year, you can **get** a better **one**?

Mr. MITCHELL. I hope **in** this measure you gentlemen will leave as much venture capital **as you can**.

Senator **LUCAS**. Under **the Knutson** bill, on a yearly basis, it would cost **6.5 billion** dollars for the fiscal year 1949, and **7.1 billion** if it were made retroactive to January 1, 1948.

Mr. MITCHELL. Yes.

Senator **LUCAS**. Do you favor the retroactive **provision**?

Mr. MITCHELL. With **the \$7,500,000,000** and the **\$2,500,000,000** on **debt**, and our **figure** of **\$10,000,000,000**, of difference between income and outgo, **yes, I** think **we** **would** be in favor definitely of going back to January 1, 1948.

Senator **LUCAS**. You would like to see the bill passed in the present form without any **reduction**?

Mr. MITCHELL. **Yes, sir**. Community property is going to help in this venture capital thing some, **Senator**.

Senator **LUCAS**. I think that is the only **thing** in it that will **help**.

Mr. MITCHELL. Any material amount, because the percentage reductions in the top bracket are not going to be so great.

Senator **HAWKES.** Mr. Chairman, I would like to say this: I think I understand what Mr. Mitchell is talking about in connection with the payment of the debt and the reduction of taxes.

A great many people in the United States failed to appreciate the only difference between the United States and the communistic, socialistic world is the fact that we have preserved initiative in this country.

A lot of people do not like to hear this, but I think what you mean is that you would like to pay the debt off at a rate that is something we have some right to hope we can keep up with, instead of making a great, tremendous payment for 2 or 3 years and then find out we have crushed initiative that keeps American machinery going, that produces the money from which we get the taxes to pay the debt. I would rather keep faith with the American people and pay the debt off consistently, year after year after year, and let them know we are going to keep faith with them, let them know their representatives have enough intelligence to know we have got to stop waste in the Government, and have got to live within our income, and not crush initiative.

Because, when you crush initiative, I give you my guaranty you will not pay the debt. You will default. We will be just the same kind of Nation we are trying to help all over the world now.

Is that your viewpoint?

Mr. **MITCHELL.** Exactly.

Senator **HAWKES.** I wanted to emphasize that because that is my viewpoint.

The **CHAIRMAN.** Thank you, Mr. Mitchell.

Mr. MITCHELL. Thank you.

The **CHAIRMAN.** Our next witness is Mr. Miller.

Mr. Miller, will you give your full name and residence and occupation, and be seated and go ahead with your statement.

STATEMENT OF WALTER P. MILLER, JR., REPRESENTING NATIONAL PAPER BOX MANUFACTURERS ASSOCIATION, PHILADELPHIA, PA.

Mr. MILLER. Mr. Chairman and gentlemen:

My name is Walter P. Miller, Jr., and I speak to you as chairman of the Government-relations committee of the National Paper Box Manufacturers Association. I am a past president of that organization and I am engaged in the set-up paper-box business in Philadelphia, as my father was before me.

Present also is Mr. W. Clement Moore, tax consultant of the National Association, who will attempt to answer any questions you might have concerning our testimony.

I wish to express my sincere appreciation of this opportunity to appear before you and to add my word of thanks for the services you are rendering to your constituents in these difficult days.

I agree mostly with what Mr. Mitchell has said, but I want to speak a little more about the little angels he mentioned a while ago, and it is my duty and privilege to represent an industry which is a rather special segment of American industry for several reasons.

First, it is, in general, small business. There are approximately 1,100 separate manufacturing establishments in the country with total sales of about 300,000,000 or an average per unit of 272,000.

Second, it is mostly local business, since set-up paper boxes, perhaps most familiar to you as the candy box, although there are many other types, are too bulky to be shipped very far economically.

Third, because of the number of manufacturing units it is highly competitive, and I would like to say already there is a buyer's market in our industry.

Fourth, because of the flexibility and adaptability of our product, it affords many opportunities for ingenuity and individual enterprise.

For these and other reasons I say very proudly that this industry exemplifies the American way of life. And, furthermore, our services are essential to many other industries, for no matter what they make or how good it is unless it can be packed, stored, and shipped, it cannot be distributed or used.

I recognize that you are considering only personal income taxes at this time and that testimony is limited to the provisions of the Knutson bill. I would, of course, appreciate an opportunity of talking with you at a later date on the subject of a general revision of taxes, but your present deliberations are important to us for a number of reasons.

As I have said, our manufacturing units are generally small and of the 1,100 operating in the country, approximately one-third are individual proprietorship or partnerships and the balance almost without exception are small, closely held, or family corporations.

For the partnership and individual owners the impact of individual income taxes is obvious and in regard to the balance I would point out that being small and local they have no access to general capital markets and additional equity capital must come from the owners or those closely associated with them. The personal income taxes of these individuals, as presently assessed, preclude the possibility of their putting more money into their businesses.

The lack of such additional capital is a very real and present danger to our industry. Our equipment was operated without respite during the war and depreciation rates have not been adequate. Today now machinery is becoming available and new processes and materials are being developed. We estimate that 5,000,000 or year in additional equity capital—and I do not mean bPnk loans which are apt to come up and kick you in the teeth when times are worse—is needed to revitalize our essential services to the community and to provide our share of the jobs needed to make America strong.

This money is not presently available and it can come from only one source—the savings of the individuals concerned. I would like to emphasize that the individuals of whom I speak—the proprietors, partners, and family owners of these businesses—are in what are known as the middle-income groups. Our surveys of the industry show that withdrawals of principals in the industry average from \$8 000 to \$10,000 per year.

Therefore, gentlemen, we need your help. I do not feel that the provisions of the Knutson bill are adequate to provide the capital formation needed in small industry. But because it represents the limit of practical possibility of tax reduction in this current year I would

like to go on record for **the** National Paper Box Manufacturers Association as giving it unqualified endorsement.

For the record, therefore, we would specifically approve **the** following provisions of H. R. 4790:

Section 101 covering the reduction in normal and surtax rates thereon.

Section 201, which provides an increase in exemptions from \$500 to \$600 for each person, and an additional \$600 for taxpayers over 65 years of age.

Section 301 providing for the splitting of incomes of husband and wife, because of the inequity which now exists **due** to this privilege having already been granted to States with community laws. We feel this would be particularly helpful in the income-tax brackets of which we speak.

Naturally, also we approve the remaining sections of the proposed act which are pursuant to the above provisions.

In conclusion, I would like to say that I **am** aware of considerable pressure on you to reduce the tax savings contained in **the** present provisions **of** the bill. If this is necessary, and I hope it is not, I would like to make a special plea for those **savings**, particularly in the middle-income brackets, from which capital formation for small business must come.

I shall not go into the necessities of national expenditures but if the proposed reduction in tax savings of the Knutson bill is based on national security I would submit to you that there is no more important factor in national security than the fortification of the jobs and facilities of small business. For that purpose **the** tax savings of **the** Knutson bill in the middle-income groups is essential.

The **CHAIRMAN**. Any questions?

Senator **HAWKES**, Mr. Chairman, I would like to say that was a very clear statement and a very excellent statement.

The CHAIRMAN. Thank you very much, indeed. We appreciate your testimony.

Mr. **MILLER**. Thank you.

The CHAIRMAN. Our next witness is Mr. Magill.

STATEMENT OF ROSWELL MAGILL, WESTPORT, CONN.

Mr. **MAGILL**. My name is Roswell Magill. My home is Westport, Conn.

I am a member of the New York City law firm of Cravath, Swaine, & Moore, and I appear here at the request of the chairman.

Senator **CONNALLY**. Are you representing any special organization?

Mr. **MAGILL**. No, sir; I am not.

Thoughtful citizens generally ask two questions about Federal tax reduction.

First: Can the Federal budget stand **it**?

Second: Would tax reduction **be** a good thing for the **country**?

The first question, stated more specifically is: What are Federal expenditures and surpluses for fiscal 1948 and 1949 likely to **be**?

The second question involves two subsidiary points. Would it be better **to** use any surplus to reduce the debt, or use it, at least in part, to reduce **taxes**? What will be the effect of tax reduction on the economy, on the production of goods, on inflation or on **deflation**?

All these questions are hard to answer. To answer them requires the exercise of good judgment applied to a lot of statistical data and to such intangibles as men's incentives to work and to produce. Reasonable men can certainly arrive at different conclusions. Moreover, the very difficulty and complexity of fiscal problems makes it easy for ignorant or unscrupulous men to confuse the issue with slogans and false statements and special pleading. A Presidential election year is not the ideal time for dispassionate analysis of any governmental or political question. The best I can do is to state as simply as I can the facts on which my own conclusions are based.

1. The Treasury's latest estimates of budgetary receipts and expenditures show an anticipated surplus of 7.5 billion dollars for 1948 and 4.8 billion dollars for 1949, or 12.3 billion dollars for the 2 years. The Treasury has erred on the side of understatement of the surplus for years. Hence, it is not surprising that the staff of the joint committee estimates the surplus at 8.8 billion dollars for 1948 and 7.6 billion dollars for 1949, or 16.4 billion dollars for the 2 years. Neither of these estimates take any account of possible reductions in the budgeted expenditures. Both sets of estimated expenditures include billions for European relief. Hence, on the face of the record the great excess of tax receipts over expenditures will permit a reasonable amount both of tax reduction and of debt reduction. Indeed, the estimated surplus approximates total Federal expenditures during the thirties. If expenditures are reduced, as Congress has resolved and as certainly should be done, the case for tax reduction becomes even stronger.

In calculating revenue losses from tax-rate reductions, the usual process is to figure that revenues will decrease proportionately with the decrease in rates. This practice overlooks the fact that tax rates, like other things, are subject to the economic law of diminishing return.

When rates are lowered, the general tendency is for revenues to drop less than proportionately and, in our past history, increases in revenue have followed tax reduction. For one practical reason, people do not wrestle quite so hard to find the last dollar of lawful deductions. Evasion is less tempting. Collection becomes easier, less costly.

The CHAIRMAN. Mr. Magill, when the reduction of taxes has been coincident with rising revenues, has that not always been in a rising economy?

Mr. MAGILL. Yes, sir. Of course, the example of what I am speaking of here occurred during the twenties.

The CHAIRMAN. So that is impossible to give that as a complete answer?

Mr. MAGILL. Right.

The CHAIRMAN. It undoubtedly has some effect, but I do not think you can say all of the increase in revenue is due to the fact of tax reduction.

Mr. MAGILL. That is right. I would think the first statement I gave here is the safer one to rely on; namely, that in estimating revenues from a decrease in taxes you can not be sure that revenues will go down proportionately to the decrease.

Senator CONNALLY. You do not mean to contend that the increase in revenues after tax reduction was solely attributable to that?

Mr. MAGILL. No.

Senator **CONNALLY**. It was just a factor, and it might have been still greater if it had not been for the tax reduction?

Mr. MAGILL. It is quite possible.

What makes this whole fiscal area so difficult to discuss is that there are so many factors that enter into all computations.

The CHAIRMAN. If you take it as correct that the reduction of taxes will give incentive, then some part of the increased revenue would be attributable to it, but I take it the difficulty is to describe the exact part.

Senator **HAWKES**. I want to say, and I think Mr. Magill will agree, just as it is true that the power to tax, if carried to excess, is the power to destroy, it is true if taxation is regulated to keep initiative and stimulate people to go into business and do things and make more money and make more goods for the people, your revenue from taxation on a lower basis can very easily be more than if taxes are too high.

Mr. MAGILL. Yes, sir. That is substantially what I am trying to say here, and I think substantially the case for this bill.

Senator **HAWKES**. I agree with you very emphatically.

Mr. MAGILL. Thus, I feel that the estimates of revenue loss involved in H. R. 4790 probably are on the high side.

2. Is tax reduction wise? In my judgment it is, for a number of reasons. In the first place, all of us would agree that economical government, like an economical family budget, is hard to achieve, in the presence of billions of dollars of surplus receipts. We ought to strive in every way we can to bring the cost of government down to a figure we can afford in less prosperous times than these. An important way to stimulate a cut in the cost of government is to give the Government less to spend.

Second, individual tax rates are too high and exemptions are meager. The individual taxpayer has had almost no relief from the tough tax rates of the war. Our country and the world needs all the production we can get. One way to get production is to give the worker and the foreman and the business manager the fruits of his labor—not to take away from him two-thirds or half or one-third of very additional dollars he earns by working harder and taking on more responsibilities.

Many analysts have observed the diminishing flow of risk capital into business. Great corporations are forced to finance themselves out of earnings, and the small corporation or the new venture has no chance to get new money in the market. The basic reason is that those citizens who normally provide risk capital out of their savings have savings so small after taxes that they invest, if at all, in Government or gilt-edge bonds. To keep our enterprise system healthy, there must be a steady flow of new risk capital into it. Taxes must be reduced to make that flow possible.

Senator **LUCAS**. Right on that point I have a question.

Mr. MAGILL. Yes, sir.

Senator **LUCAS**. You state that small corporations have no chance to get money in the market.

Senator **HAWKES**. Will the Senator speak louder, please, so we can hear you over here?

Senator **LUCAS**. I was directing my remark to the statement made by Mr. Magill: "The small corporation or the new venture has no chance to get new money in the market."

Do you have any figures to show what new businesses have come on the horizon during the last couple of years?

Mr. **MAGILL**. I'm sorry I have not, and my statement is based primarily on my own observation.

As we are all aware, the amount of new flotations, particularly of risk securities, on the market, has gone down very seriously.

I believe the figures, which I supposed were introduced before this committee, show that the total amount of equity investment in all American corporations was about \$1,000,000,000 last year out of about \$26,000,000,000 that was invested in such companies in one way or another.

And certainly so far as one's observation goes it is impossible for a small or new business, which is not known to the customers, to raise money on the market in risk securities.

Senator **LUCAS**. Is the margin required on the stock exchange a factor having to do with that?

Mr. **MAGILL**. I do not know, Senator **LUCAS**. I am not an expert on that. I should doubt it. I would not think it would. In talking about small business, I am talking about the \$5,000,000 enterprise or smaller.

Senator **LUCAS**. I understand.

It strikes me it would be enlightening to the committee to know, in view of the statements made before the committee, I think, about the failure of these new ventures because of the lack of money to know exactly how many have gone into business, in 1946 and 1947.

That might not tell us anything from the standpoint of the future which you folks are mostly arguing about.

Mr. **MAGILL**. Both of us would like to see what happened in 1947 or 1948.

The only source I can think of would be either the Secretary of Commerce or possibly Mr. Schram of the New York Stock Exchange, if he is appearing.

Senator **LUCAS**. We can get the figures.

Senator **HAWKES**. Mr. Chairman, I quite agree with what the Senator from Illinois has said.

I do not think you mean they have no chance. They have a limited chance and an unsatisfactory chance.

In other words, it is not the kind of an opportunity that encourages them to go on.

I would think you would like to change that word "No," because I think your statement is splendid but I think "No" is a little too strong.

Mr. **MAGILL**. You may be right. Actually, what I am thinking of are the cases I have had.

As I said, I am a lawyer, and do not deal with the exchange. The cases I am thinking of are cases of individuals who have a two, or three, or five million dollar business and who are getting along in their sixties or seventies, and their entire fortunes are wrapped up in their business.

They see they cannot pay their estate taxes when they die without the executor's selling out some of this stock. They come to me with

the question: "What can we do to put ourselves in a position to pay our estate taxes when we die?"

The first thing you think of is to recapitalize the business, market some securities.

Then I have actually approached various investment banking firms in particular instances of the sort I am describing, and they have said that there is just no market for that kind of security because no one ever heard of this bolt and nut company that I described.

They say they just could not sell the stock.

They could sell their debentures or bonds probably, and probably they could sell preferred, if a sufficiently high rate were fixed, but not the common stock.

Senator LUCAS. When I think of these problems, I always go back to the peak period of 1929 when we had a low rate of taxation in this country, and yet we had thousands upon thousands of business failures during that high period of prosperity, so-called.

Yet, if I read the records correctly, during 1946 and 1947, our business failures have been very few, and new businesses have come on the scene during these 2 years.

I cannot predict what the future is going to hold for us, but I do not get too excited about some of these statements that are constantly being made here.

Mr. MAGILL. I think I would certainly agree with the first half of your statement that we are enjoying a very high degree of prosperity and business failures are few.

As to the second part, the ability of the small enterprise to finance itself these days, I, like you, would like to see some figures on it.

The only figures I have seen are with respect to investment in corporate enterprise as a whole and not broken down as to big and little.

Senator LUCAS. There will always be that problem regardless of what kind of a tax structure you have.

There will always be somebody in trouble and seeking some way to find capital to go into business or to maintain themselves and keep from going into bankruptcy.

That has been the history of the country throughout.

When I think what happened in 1929, the peak year of prosperity, so to speak, before the war came on, and realize there were something like 15,000 business failures at that time, I cannot get very much excited about the present condition.

Yet, maybe I am not looking far enough ahead with respect to this risk capital.

Mr. MAGILL. I am sure you are looking far enough ahead.

I heard a discussion of that the other day by an economist.

He wound up with the agreeable conclusion that many of the factors which were responsible for the 1929 situation are not present today; there is not the same speculative interest, for instance, in the stock market today that there was then.

Senator LUCAS. That is a pretty good thing.

Mr. MAGILL. I hope he is right.

Consequently, his theory is that we will not have a bust tomorrow as we had back then.

The **CHAIRMAN**, Mr. Magill, I would like to say that just the other day I was reading a review which showed in 1947 we had an extraordinary increase in bankruptcies over 1946.

I would appreciate it, Mr. Stam, if you would get that in the record.

Senator **LUCAS**, I think that is important. I would like to see it, and also would like the information with respect to new business of different kinds.

The **CHAIRMAN**, It was very surprising to me, but it showed a very, very heavy increase in bankruptcies in 1947 over 1946.

It was in Dun's I think, last review.

Mr. **STAM**, We will get that.

The **CHAIRMAN**, Will you put it in the record, please?

Mr. **STAM**, Yes, sir.

(The information referred to follows:)

TABLE I.—*Industrial and business failures*

	Number of failures			total of liabilities (in millions of dollars)		
	1945	1946	1947	1945	1946	1947
January.....	60	60	202	4.0	4.4	13.2
February.....	66	92	238	1.0	3.0	13.0
March.....	85	86	254	3.9	4.4	15.3
.....	90	81	277	1.0	3.8	16.
.....	72	92	378	2.2	3.7	17.3
June.....	61	69	283	3.2	3.0	19.0
July.....	72	74	299	3.7	3.4	37.1
August.....			287	1.2	3.8	14.9
September.....	64	96	292	1.7	4.9	10.0
October.....	62	123	336	3.1	6.4	21.3
November.....	60	104	313	1.3	12.5	16.3
December.....	42	141	317	1.8	17.1	2.5
Total.....	810	1,130	3,476	30.0	70.4	221.0
Monthly average.....	67.5	91.2	289.7	2.6	5.9	18.4

Source: Dun & Bradstreet figures as reported in the Survey of Current Business.

TABLE II.—*Monthly data of industrial and business failures in 1946 and 1947 expressed as a percentage of the same month in 1945*

	Number of failures			Grand total of liabilities (in millions of dollars)		
	1945	1946	1947	1945	1946	1947
	Percent	Percent	Percent	Percent	Percent	Percent
January.....	100	100	243.3	100	75	258
February.....	100	139	361	100	187	813
March.....	100	101	299	100	113	392
April.....	100	90	308	100	380	1,610
May.....	100	128	525	100	168	78
June.....	100	113	464	100	94	594
July.....	100	103	415	100	92	1,003
August.....	100	104	413	100	317	1,242
September.....	100	150	156	100	285	5
October.....	100	188	442	100	207	687
November.....	100	173	422	100	62	1,254
December.....		336	65.5	100	950	1,417
Monthly average.....	100	140	420	100	227	708

REDUCTION OF INDIVIDUAL INCOME TAXES

TABLE III.—Number of firms in operation and percent change, by major industry groups, selected dates 1941-47

group	Number of firms (thousands) ¹					Percent change			
	1941	December 1942	December 1945	December 1946	December 1947	September 1941-December 1943	December 1943-December 1947	December 1945-December 1946	December 1946-December 1947
All industries.....	3,398.0	<u>2,835.6</u>	<u>3,224.1</u>	3,657.8	3,871.4	-10.6	+36.5	+13.5	+5.8
Mining and quarrying.....	23.4	26.0	26.3	27.8	28.6	+11.1	+9.6	+5.7	+2.5
Contract construction.....	243.8	<u>147.1</u>	189.22	246.4	<u>286.22</u>	-39.7	+91.6	+30.2	+16.2
Manufacturing.....	225.8	<u>227.6</u>	262.65	305.11	324.2	+8	+42.4	+16.2	+6.3
Transportation, communication, and other public utilities.....	209.2	187.9	206.1	222.3	230.0	-10.2	+22.4	+7.9	+3.5
Wholesale trade.....	146.2	144.6	143.2	168.8	181.6	-22.0	+59.3	+17.9	+7.6
Retail trade.....	1,620.8	1,318.0	1,493.0	1,694.3	1,783.4	-18.7	+35.3	+13.4	+5.3
Real estate.....	285.0	267.5	280.0	297.8	300.3	-6.1	+12.3	+4.1	+1.8
Service industries.....	643.8	<u>547.5</u>	617.5	695.4	736.8	-15.0	+34.6	+12.7	+6.0

¹ Because of rounding, totals do not necessarily equal sum of components.

² Estimated.

Source: U. S. Department of Commerce, Office of Business Economics.

The CHAIRMAN. Will you proceed, Mr. Magill.

Mr. MAGILL. Inflation will not be notably aided by tax reduction, for the reason just given. If money is saved and invested, inflationary pressures are not increased. A great part of the money left in individuals' pockets through tax reduction would be saved. Moreover, inflationary pressure is not lessened by the fact that it is the Government which is spending money for goods rather than individuals. A big Government budget is no cure for inflation.

Reduction of the debt is certainly desirable. It is possible in these years both to reduce the debt and to reduce taxes. Both should be done. Playing down the debt will not increase anyone's incentives; tax reduction almost certainly will. Reducing the debt does remove some of the inflationary potential, and so is desirable. The studies I have seen come to the conclusion that debt reduction does not and should not prevent tax reduction.

Estimates of revenue very far in advance are tricky.

War-deferred demands and overseas requirements have maintained business volume at record figures since the war and the revenue estimates are based upon a continuance of active business and high employment. Recently there have been some symptoms of readjustment. None of us wants a severe downward spiral or a depression. We can help prevent this by easing up on the tax discouragements and the drain of funds to the tax collector.

Should inflationary excesses again threaten disturbance, we will be better off productionwise with a less onerous tax structure. At the same time, under these conditions revenues will be swollen and, with a wise restraint on Government expenditures, the surplus for debt retirement can be automatically increased.

Senator HAWKES. Mr. Chairman?

The CHAIRMAN. Senator Hawkes.

Senator HAWKES. Mr. Magill, there is no better cure on the face of the earth for inflation than production, is there?

Mr. MAGILL. That is certainly my belief.

Senator **HAWKES**. It ought to be anybody's belief.

If there is a surplus of automobiles and the dealers' warehouses all over the United States are full, what happens to prices? What has been the history of the world?

It is so clear that if you encourage production by not destroying initiative, you are stopping inflation and getting back where you belong, I cannot see how anybody can fail to understand it.

Mr. **MAGILL**. I believe that is true; yes, sir.

For these reasons, I favor the enactment at this time of a bill reducing individual income taxes substantially. In my judgment, such a bill should certainly contain provisions to put taxpayers in the noncommunity property States on an equal footing for Federal tax purposes with taxpayers in the community States.

It should contain an increase in personal exemptions.

It should contain some revision of the rates.

The exact amounts of these revisions will have to be determined, of course, by the Congress in the light of the whole budgetary situation.

As it appears today, tax reduction of 4 to 6 billion dollars is possible. In my judgment, a reduction in individual income taxes of this amount, along the lines I have outlined, would be enormously beneficial to the economy.

The **CHAIRMAN**. Thank you very much, Mr. Magill. We appreciate very much your appearance.

Senator **LUCAS**. I would like to ask one question which is outside of the contents of the bill which we are discussing. During the last year a number of people in my State have discussed with me the tax that is now being made upon family partnerships by the Federal Treasury. Last year we had an amendment offered in the tax bill which was considered, but have you had any experience with that in the last year?

Mr. **MAGILL**. I have had a little, Senator, but not much. It would be my hope, and it has been discussed a great deal, that if what I will call the community-property amendment is passed, to enable married taxpayers in the noncommunity States to split income for the computation of the tax as can now be done in the community States, I would hope that if that were done the family partnership problem would largely disappear. It would not entirely disappear.

Senator **LUCAS**. It would not entirely disappear, but it would have a tremendous effect.

Mr. **MAGILL**. It would have a beneficial effect. The Treasury has litigated cases in which the family partnership consisted not merely of a man and his wife, but some of his children, and of course, that kind of a case would not necessarily be affected by the amendment contained, for instance, in the bill.

Senator **LUCAS**. It seems as if they have gone pretty far with some of the rulings.

Mr. **MAGILL**. Of course, as you all know, there is a tendency on the part of the Bureau of Internal Revenue, which perhaps is a wise policy, to run with the ball, as you might say. If they get a favorable decision from the Supreme Court, which they have in this field, they see how far it can be pushed. That is about what is being done in the family partnership field.

The CHAIRMAN. Senator Lucas, this is not the particular review that I read, but under what they call **Dun's Index**, on page 11 of their review of 1948, they show—and this goes to the annual number of failures of 10,000 enterprises—they show in 1946, 5.2; and in 1947, 14.3. But the review that I read has an even more graphic representation than that.

Senator **CONNALLY.** Those are the bankruptcies that you are talking about. Senator, some of those were sort of accumulations, were they not, on account of the war, and the bankruptcy courts were not very active and did not do much? I imagine that there is some of that.

Senator **GEORGE.** There is a picking up of bankruptcies, and especially is that true in the case of newly formed businesses, which started out to meet a special demand and the demand played out.

Senator **MARTIN.** Some of them are soldiers who have started in business.

Senator **GEORGE.** They ventured into new fields without previous experience, and there has been a pick-up of failures.

Sector **JOHNSON.** Much of it has been caused by failure to buy materials and machinery.

Senator **LUCAS.** They could not get what they needed.

The CHAIRMAN. Thank you very much, Mr. **Macmill**

The CHAIRMAN. We will hear one more witness before lunch, Mr. **Foosaner.**

Will you be seated, please, and give your full name, address, and occupation to the reporter?

STATEMENT OF SAMUEL J. FOOSANER, CHAIRMAN, FEDERAL TAX LAWYERS COMMITTEE, NEWARK, N. J.

Mr. FOOSANER. My name is Samuel J. **Foosaner.**

Senator **LUCAS.** Mr. Chairman, I have to leave but I would like to have the staff look up some information on that bankruptcy question in some detail, because I think it is very important.

The CHAIRMAN. That will be done.

Mr. FOOSANER. My address is Upper Montclair, N. J., and I am a Federal tax lawyer engaged in private practice.

Senator **Millikin** and gentlemen, I appear here on behalf of the Federal Tax **Lawyers** Committee, a committee consisting of a group of Federal tax attorneys in various parts of the country specializing in Federal tax and correlated law. Over a period of approximately 6 months this committee has been engaged in a study of the present Federal tax laws with a view to the preparing of a comprehensive report. It is contemplated that copies of this report, which will embody recommendations for remedying prevailing inequities in the Internal Revenue Code, will be placed before the members of this honorable body.

In considering **H. R. 4790**, it is most essential that the over-all congressional objectives be viewed simultaneously. To intelligently determine what should be done necessarily presupposes an understanding of what can be done. Any action taken should endeavor to

Treat all of our citizens on an equitable and nondiscriminatory basis; Take cognizance of prospective requirements for foreign relief presently contemplated;

Offer an adequate response, anticipatorily, to **the** current international situation; and

Fully consider the prospective Federal surplus for the fiscal year ending June 30, 1948.

That a need for substantial tax relief for American taxpayers exists is not to be questioned. Very little relief has been forthcoming since the substantial increases in tax rates encountered with the enactment of the Revenue Act of 1941.

Compared to the year 1929, a most prosperous one, the demands upon the American taxpayer today are incredible. By way of a few comparisons: In 1929, a man with a \$4,000 net income, after exemptions, paid a \$60 tax. On the same income, in 1947, he paid \$798, or over 13 times as much. A taxpayer with a net income of \$8,000, after exemptions, in 1929, paid \$180 in taxes; in 1947, \$1,862, or over 10 times as much. A taxpayer with a net income of \$25,000, after exemptions, paid a tax of \$1,450 in 1929, and \$9,634 in 1947. In 1929, the top surtax bracket, that is, net income over \$100,000, was taxed at a rate of 25 percent.

The CHAIRMAN. Is this a married man or a single man?

Mr. FOOSANER. It is any individual, after exemptions, sir.

Under the law today, the top combined normal and surtax rates total approximately 86 1/2 percent.

In 1929, the national income approximated \$87,000,000,000. While the national income in 1947 was more than twice that of 1929, the average taxpayer today is carrying from 4 to 14 times the income tax load.

Here are several observations. A man with a \$25,000 net income, after exemptions in 1929, paying \$1,540 in income taxes, had approximately \$23,500 for his own use. Under the law today, with the same income, a taxpayer pays \$9,640, and is left with approximately \$14,400. Noting that approximately 50 cents in 1929 bought what costs \$1 today, in effect a taxpayer who was permitted to spend approximately \$23,500 in 1929 must manage to get along on approximately \$7,200 today.

It might be added that even if a taxpayer earned twice as much, or \$50,000, in 1947, he would still only have about half as much to spend as he had in 1929 with half of the income.

Under the Federal income tax law today, citizens of community property law States are favored. On the other hand, by virtue of amendments to the Code made through the 1942 Revenue Act, citizens of community property States are subject to certain additional estate and gift tax burdens, with which citizens of noncommunity property States are not concerned. While all citizens should enjoy split-income tax benefits, cognizance must be taken of the 1942 estate and gift tax provisions affecting citizens of the community property States.

Succinctly, H. R. 4790 provides the following:

1. Increased personal exemptions for taxpayers and dependents from \$500 to \$600.

2. Split-income tax benefits for spouses in all States.

3. Repeal of 1942 community property amendments.

4. New estate tax provisions.

5. New gift tax provisions.

6. Additional \$600 exemption to taxpayers attaining age 65.
7. Additional \$600 exemption for blind taxpayers.
8. Income tax rate reductions.

Observing the higher cost of living, citizens in the lower income tax brackets would be greatly assisted financially by an increased personal exemption from \$500 to \$600.

In practical operation, the savings here would be substantial. A table has been attached to indicate the variance in these savings.

It has been estimated that by increasing exemptions from \$500 to \$600, approximately 6,000,000 low-income earners would be removed from the roll of taxpayers. It has also been estimated that the over-all decrease in Federal revenue here would be \$2,000,000,000. This would not constitute a complete loss, however, since by reason of removing the 6,000,000 taxpayers, substantial savings in administrative outlays would be effectuated. The Federal Tax Lawyers Committee favors these increased personal exemptions.

There are at the present time 12 States which have community-property laws. In addition, of course, is the possession of Hawaii. Oklahoma enacted its present community-property law in 1945. Oregon, Michigan, and Nebraska all enacted community-property laws in 1947. In each of these instances, the sole motivating factor for the enactment of a community-property law was to effectuate income-tax savings for the married citizens of the above respective States. Pennsylvania also enacted a community-property law for the avowed purpose of securing income tax benefits. This law was declared unconstitutional on November 22, 1947 by the supreme court of that State.

In New Jersey, a bill has been introduced for enactment of community-property law in that State. Rhode Island has appointed a special committee with a view to adopting a community-property law, and in New York the subject is being seriously discussed. The married citizens of the 36 non-community-property States have been discriminatorily treated from an income-tax viewpoint. The citizens of the country, as a whole, favor the split-income tax treatment for married couples of all States. I say that advisedly, having discussed that situation with many citizens in the 12 community-property States.

It has been estimated that a law enacting the split-income benefits would result in a revenue loss to the Treasury of approximately \$600,000,000. The Federal Tax Lawyers Committee favors such a split-income tax bill.

Repeal of 1942 community-property amendments is another factor. H. R. 4790 proposes a repeal of the following sections of the provisions of the Internal Revenue Code:

811 (d) (5) respecting the inclusion generally of community property transferred in contemplation of death.

811 (e) (2) respecting the inclusion generally of all community property in the gross estate of the spouse who is the first to die.

811 (g) (4) respecting the inclusion generally of life insurance proceeds where premiums were paid from community-property funds.

1000 (d) which presently provides that all gifts of community property are considered to be the gifts of the husband, with certain exceptions.

It is believed that the citizens of the community-property States are entitled to some alleviation from the present provisions of the sections above enumerated. It is also concluded that an outright repeal of the 1942 amendments, however, will once again discriminatorily favor these citizens as against those domiciled in non-community-property States. Recognizing this fact, an endeavor has been made through the new provisions contained in H. R. 4790 to equalize the tax treatment of all citizens for estate and gift tax purposes insofar as is practicably possible.

The CHAIRMAN. Roughly speaking, it simply extends the splitting feature to estate and gift taxes.

Mr. FOOSANER. It attempts to do that but simultaneously invites some ambiguities that I would like to touch upon.

A studied consideration, however, of the various new provisions contained in H. R. 4790, leads us to the conclusion that provisions as presently proposed leave much to be desired. Admittedly, the provisions treat with some very difficult adjustments. This being so, maximum care and study must be devoted to avoid ambiguities. Only such provisions as will treat all citizens fairly for estate and gift-tax purposes and as will simultaneously be capable of meeting most of the situations which are likely to be presented, should be enacted into the new law.

In a conviction that this entire question of new adjustments to accomplish an equalization of estate and gift tax treatment for all citizens requires a great deal of further study, it is recommended that:

1. The estate and gift tax sections above referred to be repealed with the enactment of the current tax reduction law; and
2. That the proposed estate and gift tax equalization provisions be studied further with a view to accomplishing both greater clarification and simplification.

It seems to me, if I may point out to this body, that this law as drafted might possibly invite a multiplicity of interpretations.

The CHAIRMAN. Have you discussed the matter with Mr. Stain, the director of our committee?

Mr. FOOSANER. I have not had occasion to do so.

The CHAIRMAN. I wish that you would get in touch with Mr. Stain and have a talk with him while you are here.

Senator GEORGE. In what sort of a situation would it lead to a lot of ambiguities and uncertainties? Can you give us one example?

Mr. FOOSANER. For example, under the new proposed estate tax law, there would be a so-called marital deduction.

Senator GEORGE. That is under the gift taxes?

Mr. FOOSANER. Under the estate-tax law. The marital deduction would prevail in favor of a spouse. That is circumscribed by certain limitations. So it is provided, that if one spouse say the wife, has a right to have all of the income from the corpus of the trust, the testamentary trust, with no right to invade any portion of the corpus, either through herself alone or in conjunction with another trustee or trustees, but has full power of appointment and full power to generally dispose of the entire estate, the marital deduction is warranted.

Senator GEORGE. You have then effected a division of the estate.

Mr. FOOSANER. Yes.

Now, to get it down concretely, Senator George, assume, that subject to the new limitation, \$1,000,000 is left in the form of testamentary trust for the benefit of the surviving wife only to tile extent of its income. There are no children. She has a full power of disposition of the corpus. She outlives her husband by 15 years, and then through her last will and testament, through tile exercising of a general power of appointment, leaves tile entire \$1,000,000, which has remained intact because she has had no right to invade the corpus, to a second cousin. This, as I see it—and I am not trying to interpret it for tile courts—would permit tile passing of this entire \$1,000,000 so left in trust, to a second cousin tax-free, at the time of the husband's death. The marital deduction would be permitted in the computation of the original estate by virtue of the fact that the wife had no right to invade tile corpus during tile period of the testamentary trust, notwithstanding the fact that she had a full general power of appointment to any individual or individuals.

Senator GEORGE. Under this bill she could dispose of it to any class, second cousin, or even strangers.

Mr. FOOSA ER. Total strangers, as I read it.

Senator GEORGE. If that is right, it does look like it goes a little too far.

The CHAIRMAN. Let me repeat my suggestion that you get in touch with Mr. Stam, who is the Director of the Joint Committee on Internal Revenue Taxation, which advises this committee and the House Ways and Means Committee on the technical draftsmanship of these bills, and I am sure that he would like to have tile benefit of your comments.

Mr. FOOSANER. I might add, if Senator George desires me to do so, that while this seeks to equalize from an estate- and gift-tax viewpoint, it completely ignores a situation, for example, where a man is divorced or his wife is dead and he has four or five infant children. In such a situation there would be no such thing as a marital deduction because these new provisions of H. R. 4790 deal with spouses only.

I might also supplement my comments by saying that one of the estate-tax provisions of the Internal Revenue Code which would be repealed, introduced by the 1942 amendments in the act adopted then, would, subject to the new proposed limitations, now remove life insurance proceeds payable upon the death of the decedent, with premiums from community property, from his gross estate. Today, in 36 non-community-property States, where a man pays premiums directly or indirectly, or possesses any of the legal incidents of ownership in a life-insurance policy, either exercisable by himself alone or in conjunction with some other person at time of death, all of the proceeds irrespective of the fact that they may be payable to a named beneficiary or named beneficiaries, are held to be includible in his gross taxable estate. But through the repeal of 811 (g) (4), all premiums can be paid from community property, which as a practical matter may have emanated or originated with the deceased spouse, the husband, and yet these proceeds, subject to the over-all limitation presently proposed, will be excluded in computing the adjusted gross estate.

I mention those as some of the thoughts that struck me in trying to reconcile the various aspects of this bill.

The CHAIRMAN. You may proceed.

Mr. FOOSANER. Observing the present national income, the probable Federal surplus at the end of the current fiscal year and the tax relief which our taxpayers require today, it is concluded that an over-all tax reduction of \$1,000,000,000 should be resently made.

The new split-income tax law, the increased personal exemptions, and the repeal of the estate and gift tax provisions affecting citizens of community-property-law States, will result in a total loss of revenue aggregating somewhat less than \$3,000,000,000. An additional billion dollars in the form of income-tax-rate reductions can, and should, be made at this time.

Senator **GEORGE.** I think that you have pointed out, and as I read the House bill, it does seem to go a bit too far. While the 1942 act as it was construed was unfair in the community-property States with reference to the estate tax, this bill does seem to go a bit too far, and I hope it will be studied, Mr. Chairman.

Mr. FOOSANER. As a matter of fact, I might say this, Senator George, for the temporary alleviation that the residents of community-property States might receive by virtue of a some \$60,000,000 loss in revenue as contemplated, there is an offsetting series of complicated situations which they encounter, not sustained by citizens of noncommunity property States. One of the finest things that happened, probably, in the State of Pennsylvania, was for the supreme court of that State to declare its law unconstitutional on November 26, 1947, because the citizens of that State became involved in many complicated and intricate problems.

Senator **GEORGE.** I think so, too. I hastily read that law, and I would have regretted it very much had I the responsibility of interpreting and administering it.

Mr. FOOSANER. My only purpose in making that last comment is to indicate that even if, in the final analysis, citizens of community-property States were to receive a slight estate- or gift-tax advantage. This advantage would be more than offset by the burden or responsibility that they must carry.

Senator **GEORGE.** They will have some additional burdens that they must carry that you do not get by merely splitting the income for income-tax purposes.

Mr. FOOSANER. I should like to file these schedules with the committee.

(The schedules referred to follow:)

Names and addresses of members of Federal tax lawyers committee

Robert Ash, Esq.-----	Washington, D. C.
Milton Elrod, Jr., Esq.-----	Indianapolis, Ind.
George J. Lalkin, Esq.-----	Milwaukee, Wis.
Charles A. Morehead, Esq.-----	Miami, Fla.
George E. Ray, Esq.-----	Dallas, Tex.
Leon L. Rice, Jr., Esq.-----	Winston-Salem, N. C.
Samuel J. Foosaner, Esq., chairman-----	Newark, N. J.
Martin M. Lore, Esq., secretary-----	Newark, N. J.

SCHEDULE A.—Personal income tax comparisons for years 1929, 1937, 1941, and 1947

Net income after exemptions	Tax in 1929 ¹	Tax in 1937 ²	Tax in 1941 ³	Tax in 1947 ⁴
\$4,000.....	\$60	\$160	\$460	\$798
\$8,000.....	180	500	1,230	1,862
\$15,000.....	560	1,290	3,320	4,494
\$25,000.....	1,540	3,070	7,640	9,643
\$50,000.....	3,260	9,700	21,380	25,479
\$100,000.....	16,440	34,000	53,760	63,954

¹ Top bracket (on excess over \$100,000) was 25 percent.² Top bracket (on excess over \$5,000,000) was 79 percent.³ Top bracket (on excess over \$5,000,000) was 81 percent.⁴ Top bracket (on excess over \$200,000) is 86.45 percent.

Under present law: Income-tax rates aggregate a surtax and normal tax of 19 percent on first \$2,000. Thereafter, surtax rates increase, so that normal and surtax on income in excess of \$200,000 is 86½ percent. Limitation on total tax cannot exceed 85½ percent of net income. Personal exemptions, \$500 for each dependent.

SCHEDULE B.—Statistical information on U. S. Government finances

	National income	Federal receipts	Personal taxes	Corporate profits taxes	Federal expenditures	National debt ¹
	Nearest billion	Nearest billion	Millions	Millions	Nearest billion	Nearest billion
1929.....	87	4	1,283	1,253	3	17
1930.....	75	3	1,134	750	3	16
1931.....	59	2	607	425	4	17
1932.....	42	2	331	325	3	19
1933.....	40	3	174	465	4	23
1934.....	49	4	595	640	6	28
1935.....	57	4	827	834	7	33
1936.....	65	5	1,130	1,254	9	38
1937.....	74	7	1,723	1,347	7	41
1938.....	67	6	1,635	906	8	42
1939.....	73	7	1,235	1,306	9	45
1940.....	81	9	1,364	2,679	10	49
1941.....	104	16	2,016	7,569	21	55
1942.....	136	23	4,668	11,321	56	77
1943.....	168	39	16,517	13,792	86	141
1944.....	182	42	17,536	13,454	96	203
1945.....	183	43	19,379	10,542	85	259
1946.....	178	39	17,211	8,151	37	290

¹ The National debt as of the fiscal year ended June 30, 1947 was \$238,000,000,000. Mated debt for the fiscal year 1948, as per Daily Statement of U. S. Treasury Department, March 4, 1948, is \$254,162,595,772

SCHEDULE C.—Comparative taxes under present and increased exemptions

Married couple with—	Net income	Under present \$500 exemption				Under proposed \$200 exemption ¹		
		Exemptions	Deduction under optional tax table	Income subject to tax	Tax	Exemptions	Tax	Savings
2 children.....	\$3,000	\$2,000	\$300	\$700	\$133	\$2,400	\$57	\$76
3 children.....	3,000	2,500	300	200	38	3,000	None	38
4 children.....	3,000	3,000	300	None	None	3,000	None	None
5 children.....	3,000	3,500	300	None	None	4,200	None	None
2 children.....	4,000	2,000	400	1,600	304	2,400	228	76
3 children.....	4,000	2,500	400	1,100	209	3,000	114	95
4 children.....	4,000	3,000	400	600	114	3,600	None	114
5 children.....	4,000	3,500	400	100	19	4,200	None	19
2 children.....	5,000	2,000	500	2,500	485	2,400	401	84
3 children.....	5,000	2,500	500	2,000	380	3,000	285	95
4 children.....	5,000	3,000	500	1,500	285	3,600	171	114
5 children.....	5,000	3,500	500	1,000	190	4,200	57	133

¹ 10% deduction under present optional tax table also available here.

Mr. FOOSNER. May I thank you very kindly.

The CHAIRMAN. Thank you very much for coming.

We will recess until 2 o'clock.

(Whereupon, at 12:30 p. m., the hearing was recessed until 2 p. m. of the same day.)

APPROCEED

(The committee reconvened at 2 p. m., upon the expiration of the recess.)

The CHAIRMAN. Is Mr. Silberstein here?

Mr. SILBERSTEIN. Yes, sir.

The CHAIRMAN. We will proceed with the hearing. I am sorry there are not more Senators here, but we are having a foreign affairs debate upstairs. Three of our members are members of the Foreign Affairs Committee.

Will you state your name, residence, and occupation?

STATEMENT OF ROBERT J. SILBERSTEIN, ATTORNEY, EXECUTIVE SECRETARY OF THE NATIONAL LAWYERS GUILD, WASHINGTON, D. C..

Mr. SILBERSTEIN. I am Robert J. Silberstein. The address is 902 Twentieth Street NW, Washington, D. C. I am a lawyer, and the executive secretary of the National Lawyers Guild, in whose behalf I testify.

This statement, sir, was prepared by our national committee on taxation, which is composed largely of lawyers who are tax specialists. and the views expressed in the statement were approved by our national convention in Chicago on February 21.

The tax legislation to be adopted by Congress at its current session can play an important role in staving off or mitigating the precipitous economic collapse which may follow the current inflationary boom. The tax policies to be adopted will also leave their impact on the standard of living of the American people. Both the administration and the Republican leadership recognize the vital importance of the tax policy on economic events.

H. R. 4790, in our view, will neither contribute substantially to curbing inflation nor to safeguarding the standard of living of the American people. It is offered under the guise of giving proportionately greater tax reduction to the lower-income-bracket taxpayers than to the higher-income levels. In fact, however, it favors the higher-income levels over the lower-income levels. Thus, a married man with two dependents, earning \$3,000 a year, will have his tax cut by \$110; and his take-home pay will be increased by 4 percent. If he earns \$10,000, his tax will be cut by \$652, and his take-home pay will be increased by 10 percent.

Mr. SILBERSTEIN. I cannot tell you that exactly.

The CHAIRMAN. How much does a \$3,000 man pay?

Mr. SILBERSTEIN. Certainly the \$10,000 man pays more tax. The point we are making here is that the percentage of saving which goes to the higher-bracket taxpayer is very much larger than the percentage saving which goes to the lower-income taxpayer.

The CHAIRMAN. Would you not say that the amount of tax paid by the two different persons mentioned by you would have some taking into that?

Mr. SILBERSTEIN. It would have some bearing, of course. But it seems to us that a primary consideration in the question of income tax is what is best for our economy and where is tax relief most needed.

It is our view that it is the lowest income-tax payer whose standard of living is declining under a period of inflation and uncontrolled prices and that the greatest relief is needed in that area.

The CHAIRMAN. Mr. Silberstein, were you are on a progressive income-tax system, you would not argue that the dollar savings per person in each bracket should be exactly the same, would you?

Mr. SILBERSTEIN. No, sir. And I have not made that point. I have made the point that as you go up, the percentage is increasing. If, for instance, one with a \$10,000 income receives a 4-percent reduction, just as a taxpayer in the \$3,000 bracket receives a 4-percent reduction, obviously the first will receive more money.

The CHAIRMAN. Is it not true, Mr. Silberstein, that starting afresh, with a new income-tax system which is on a progressive rate, is not the percentage of savings of those with the higher progressive rates substantially less percentage-wise than those in the lower progressive rates?

Mr. SILBERSTEIN. I think that if you were starting afresh, if you were starting afresh, you would not have any question of saving.

The CHAIRMAN. Of course you have a question of saving. Where do your savings originate? They originate out of your take-home pay, whether it is your worker's take-home pay or your investor's take-home pay. Is that not correct?

Mr. SILBERSTEIN. Yes, sir.

The CHAIRMAN. And in a progressive tax system where you are starting afresh if you have a progressive income-tax system do you not necessarily decrease the percentage of savings as you go up?

Mr. SILBERSTEIN. I think, sir, that you increase the percentage of savings as you go up.

The CHAIRMAN. No. You decrease them. You are bound to.

If the lowest man has 98 percent disposable income, as a result of a progressive income-tax system and the highest man has 20 percent disposable income, have you not, in the establishment of that system, reduced the savings of your top man?

Mr. SILBERSTEIN. I am afraid I do not understand the question, sir.

The CHAIRMAN. We will hang on this if it takes till day.

Mr. SILBERSTEIN. Very good.

The CHAIRMAN. We establish today a progressive income-tax system. We fix the rates so that the man in the lowest bracket retains 98 percent of his income. We fix it so that the man at the top retains 20 percent of his income. Have you not, percentage-wise, cut the savings of the man at the top more, percentage-wise, than the man at the bottom?

Mr. SILBERSTEIN. Yes. I must acknowledge that.

The CHAIRMAN. Does it not follow that when you are reducing you must necessarily reverse the process?

Mr. SILBERSTEIN. No, sir.

The CHAIRMAN. Then that would be a heads I win and tails you lose game, would it not?

Mr. **SILBERSTEIN**. No, sir. Our position on what we mean by progressive taxation is taxation on the basis of ability to pay and the main basis of the statement we present is that the taxpayer, with a wife and two children, must have an income of approximately \$1,000 to current cost of living in order to be able to maintain his family at a minimum standard of decency.

And we say that a sound progressive system of taxation will not tax that man at all if it is possible to avoid it and meet the necessities of Government.

The **CHAIRMAN**. Where would you get the taxes necessary to meet the other necessities of Government?

Mr. **SILBERSTEIN**. In the present situation we have, according to the view of the Congress, as I understand it, a certain amount of money which can be allowed in tax reduction. Obviously we have that sum which can be allowed. We also have certain other proposals for increasing the income from taxes in other areas where it can be afforded and where it will, in our view, be more equitable to obtain the necessary additional income.

The **CHAIRMAN**. You agree to the system as it goes up, but you say as we reach a point where taxes can be reduced that we should not adhere to the same system in reduction?

Mr. **SILBERSTEIN**. That is right, sir.

The **CHAIRMAN**. All right. Go ahead.

Mr. **SILBERSTEIN**. If he earns \$20,000, his tax will be cut by \$2,233, and his take-home earnings after taxes will be increased by 16 percent; and if he earns \$100,000, his tax will be cut by \$18,076, and his earnings after taxes will rise by 48 percent.

A married couple with two children, if they are living in a typical large American city need approximately \$4,000 a year to maintain a minimum standard of decent living, according to the authoritative cost of living studies of the Heller Committee of the University of California. Yet, this family is called upon under the proposed bill to pay \$1.50 a week, or \$80 a year, in Federal income taxes, and the married couple without children \$2 a week, or \$106 a year. These families are the victims of uncontrolled prices; their standard of living and health are threatened. It is highly inequitable and a violation of the basic democratic principle of taxation according to ability to pay to levy any peacetime income taxes on these inadequate incomes, while at the same time reducing the tax on persons with substantially higher incomes.

The proposal to allow husbands and wives to split up their income for tax purposes is a particularly shocking piece of tax "relief" granted exclusively to the higher income levels. For years ingenious tax lawyers have wracked their brains to create family trusts, family partnerships, family corporations, and a whole myriad of schemes to split family incomes, all designed to reduce surtaxes and still keep income within the family.

The Treasury, after years of struggle in the courts and in Congress, has finally succeeded in defeating most of these tax-avoidance schemes. Now, it is proposed to undo these years of struggle against tax avoidance and in one fell swoop allow husbands and wives to split their incomes for tax purposes.

Thus, a man who has a net income of \$10,000 to \$12,000 is subject to a top surtax under present rates of approximately 36 percent. If the

community-property provision becomes effective, he would report \$5,000 and his wife \$5,000 and their top surtax bracket would be approximately 25 percent. At \$30,000 the surtax bracket is about 59 percent, but by splitting the income between husband and wife for tax purposes, the top surtax rate would be reduced to about 45 percent.

No married couple, without children with an income under \$3,300 would receive the slightest benefit from this proposal; and no man and wife with two children would receive the slightest benefit from this proposal unless their incomes exceed \$4,000 under present rates. That is because whether the income is reported by the husband alone or is split between the husband and wife, their incomes would still be in the first surtax bracket.

The significance of these figures is indicated by the fact that the Treasury estimates that approximately 70 percent of all taxpayers will have incomes of \$4,000 or less. Government figures disclose that 97.5 percent of the \$800,000,000 tax reduction growing out of the community-income proposal will go to the 20.9 percent of these families with incomes over \$5,000.

The CHAIRMAN. Have you made an analysis of the percentage of the reduction that would go to taxpayers with less than \$5,000 a year as contrasted with those above \$5,000 under the Knutson bill?

Mr. SILBERSTEIN. My understanding is that a larger percentage of it would go to the lower income bracket.

The CHAIRMAN. Would you increase the percentage in the upper brackets?

Mr. SILBERSTEIN. We would in some situations.

The CHAIRMAN. What are they?

Mr. SILBERSTEIN. We have concrete proposals here. We propose, for instance, a-you mean in relation to individual incomes? I believe that we do not make that proposal. We do in relation to corporate incomes propose that corporate taxes also be levied on a progressive basis instead of a single rate.

The CHAIRMAN. If your theory of greater relief for those in the lower brackets were to obtain, where would the revenue come from to make that good?

Mr. SILBERSTEIN. The revenue would come by allowing less to those in the upper brackets.

The CHAIRMAN. Their that is what I was getting at. The upper brackets.

You feel that that is just and equitable?

Mr. SILBERSTEIN. We do feel that that is just and equitable, sir. And I want to say, in relation to the question of stimulus for further investment, for capital accumulation about which we heard so much this morning, that it is our view that with the highest income practically we have ever had in terms of profits in history, amounting to some \$18,000,000,000, and a net return to corporations of approximately 9 1/2 percent of net invested capital, there is certainly ample inducement for equity investment.

If, however, there is a shortage, it is our view that this is due to the feeling on the part of potential investors—and I may say I am included among them—that our economic situation is unstable, that we are likely in the near future to run into a economic depression, and therefore people are waiting.

They, like my myself, are investing in Government bonds, because we want a secure return until there is some balance established in the economy and we can get away from the threat of an impending economic crisis.

The CHAIRMAN. Do you challenge the statistics which have been offered here bearing on the subject of shortage of risk capital?

Mr. SILBERSTEIN. I do not, sir. Not that I acknowledge them, but I do not know what the facts are. However, I am willing to accept them. What I quarrel with is the conclusion drawn from the facts that there is a lack of equity capital because the returns, after taxes, are inadequate. I believe that that is refuted by the fact that we have an \$18,000,000,000 corporate income after taxes and a 9½ per cent return on invested capital.

The CHAIRMAN. If the returns were adequate, is it not perfectly apparent to you, under your own theory, with all this money available for investment which you portray as a result of these profits, that people would be buying those equities?

Mr. SILBERSTEIN. No, sir.

The CHAIRMAN. Do you attribute to the capitalistic system the kind of stupidity represented by a man's failure to buy a good equity if he thinks he can make money out of it?

Mr. SILBERSTEIN. Sir, I do not believe that that is stupidity. That is the view which I have and which many people have, and I have had occasion to advise investors. They feel, and many very well qualified economists feel, that with the inflation we have now we are heading toward a bust.

The CHAIRMAN. What good will your Government bonds be then?

Mr. SILBERSTEIN. Your Government bonds will be the most secure investment that one can possibly make. We have had busts before and our Government bonds have not failed. I do not know that in our history Government bonds have not been paid fully.

The CHAIRMAN. But in history they have failed when the depression has been deep enough. Is that not correct?

Mr. SILBERSTEIN. Not to my knowledge, sir.

The CHAIRMAN. The whole world is full of worthless government bonds.

Mr. SILBERSTEIN. I am referring to the United States.

The CHAIRMAN. The United States is not immune from the same laws that destroy other countries; is it?

Mr. SILBERSTEIN. That is very trite, but it still seems to me perfectly logical for an investor to withhold investment from something which is more risky and to put it into the least risky thing.

The CHAIRMAN. You not agree with me that the United States bond in the end is no better than the economy of the country? Where will the validity of the bond generate its strength?

Mr. SILBERSTEIN. ... you say is completely true if we have a total collapse of our economy. But we are not likely to have that situation.

The CHAIRMAN. And if everybody puts their money in Government bonds you will have a total collapse of your economy; will you not?

Mr. SILBERSTEIN. But I do not think that is what is going to happen. I think if we have an adjustment in our economy, which is the thing that we should strive for, that this capital investment fund which is available will be invested with the feeling that there is some security

in it. But people feel now that the conditions we have are temporary. It is unnatural.

We have an inflationary situation in which we are likely at any moment to have a recession, or perhaps a depression. They are, reluctant at this point to invest. I think they want something to be done which will contribute toward the stabilization of the economy. And we think the kind of a tax plan we propose will do that.

The CHAIRMAN. During the course of your remarks will you delineate for us just how we can make this economy stable so that people will not fear it any longer?

Mr. SILBERSTEIN. Sir, it is my understanding that the major factor contributing to instability and uncertainty at the moment is excessive prices, inflation, and that we advocate controls to be sure that prices do not go higher.

And the other side of the picture, we feel that there is a declining purchasing power which is diminishing the sound market which is available for the enormous productive capacity of our industry. And we believe that steps which tend to increase purchasing power in the hands of the masses of the people increase the possibility of continuing high levels of production.

The CHAIRMAN. If we are going to increase purchasing power you have to increase production; do you not?

Mr. SILBERSTEIN. Not necessarily.

The CHAIRMAN. Please explain that.

Mr. SILBERSTEIN. If in the existing situation we increase the purchasing power in the hands of the lowest income groups, which we are proposing—the people who do not have enough income to buy the necessities of life—we will have a larger stable market for the things which are produced.

The CHAIRMAN. You would have to increase production, would you not?

Mr. SILBERSTEIN. We do have certain shortages at this time. But we do not believe that the prices which prevail are necessary, as a working out of the law of supply and demand in an abnormal situation such as we have now with pent-up demand.

The CHAIRMAN. Do you not agree that if you want to increase the purchasing power of the people you are talking about, in real terms, you have to increase production?

Mr. SILBERSTEIN. There are two ways in which that can be done, I believe, sir. One thing that we can do is to decrease prices. That will increase their purchasing power.

Another thing that we can do is to take out of the hands of people who have more than enough for their needs, and put it into the hands of people who have less than enough, and create a stability in the economy—a really large, stable purchasing power—which we believe will bring out investment capital and make possible increased production.

The CHAIRMAN. Which way do you propose to do it? Do you propose to do it by arbitrarily decreasing prices or how do you propose to do it?

Mr. SILBERSTEIN. We propose, first—I did not think that we were going to get into this, but I am very happy to be given the opportunity.

The CHAIRMAN. I want your thoughts on this.

Mr. **SILBERSTEIN**. We are proposing, on the one hand, that prices be not permitted to rise further. In other words, a price freeze.

We are proposing further that profit margins be reduced to a reasonable level.

The **CHAIRMAN**. In every business?

Mr. **SILBERSTEIN**. Yes; in every business.

The **CHAIRMAN**. In every single business?

Mr. **SILBERSTEIN**. Every business, based on a normal period of income.

The **CHAIRMAN**. You would then have to have a control system competent to analyze the price margin in every single business of the United States. Is that not right?

Mr. **SILBERSTEIN**. Sir, what we would have is a situation—

The **CHAIRMAN**.... Is that correct?

Mr. **SILBERSTEIN**. What we would have, sir, is a situation substantially the same as we had before price controls were done away with.

The **CHAIRMAN**. Are you advocating a resumption of that?

Mr. **SILBERSTEIN**. We are, sir.

The **CHAIRMAN**. And do you think that that will increase the goods for the people you are talking about?

Mr. **SILBERSTEIN**. It will not increase the goods for the people that we are talking about—well, it would increase the purchasing power that is available to the people in the lowest income brackets.

The **CHAIRMAN**. What good does that do if you do not have the goods to buy?

Mr. **SILBERSTEIN**. We have now a higher level of production than we have had, I believe, at any other time in our history.

The **CHAIRMAN**. Do you believe that the more production the greater the cost?

Mr. **SILBERSTEIN**. No; we believe, sir, that if there is not this rising inflation on the one hand, and a decreasing purchasing power on the other hand, in the average citizen, then there will be a real incentive for increased production because there will not then be the need to feel that an investment may be an extremely risky thing as we are heading toward economic collapse.

The **CHAIRMAN**. That has been tried since the beginning of time. Give me a citation where you have achieved the objectives to which you talk under the controls of the kind that you have referred to.

Mr. **SILBERSTEIN**. Sir, we found that under this system of controls, which we have had only one time during the war, and—

The **CHAIRMAN**. The world is full of instances.

Mr. **SILBERSTEIN**. Where we have had abnormal shortages and in that situation it was found that prices were held substantially in line.

The **CHAIRMAN**. And you could not get the goods.

Mr. **SILBERSTEIN**. And you could not get the goods. That is true.

The **CHAIRMAN**. That is what you call a desirable objective? That is what you want to go back to?

Mr. **SILBERSTEIN**. No; that is not, sir. We do not believe that you are going to have a reduced amount of goods if you have an establishment of control which stops any further inflation, and which keeps profit margins at a reasonable level.

Now, our production under price control in the period of the war was very great. I think it is the greatest we have ever known in history and of course, in the short period following the war we had a reconversion which was holding back production of civilian goods which created some shortages. And also we had a hold-back on production or at least on things which were put on the market, as soon as it became apparent that there was a possibility, of weakening or doing away with price controls, in order to create pressure in that direction.

But prior to that we did not have a shortage of production. As I understand it, according to the figures of governmental agencies.

The CHAIRMAN. During OPA we did not have a short age of production?

Mr. SILBERSTEIN. We did not.

The CHAIRMAN. You had the kind of production then that you want for your people?

Mr. SILBERSTEIN. During most of the period, sir, during the period of the war we had war production and naturally we had great shortages in civilian goods. We are not talking about that.

The CHAIRMAN. That is bound to follow because you are putting your emphasis on war production.

Mr. SILBERSTEIN. That is right.

The CHAIRMAN. But when we got rid of that, and continued those controls, we did not get rid of our goods shortages because we did not get our production going.

Mr. SILBERSTEIN. We did not get rid of our goods shortages because, during most of the period following the war, we were in a reconversion stage and in the very short period beyond that, up to the end of controls, there was a situation existing which indicated the possibility of doing away with controls or weakening them. Under that situation it was quite natural that business people should hold back production in order to augment this shortage and increase the pressure for doing away with controls. And beyond that, the quite natural economic incentive, that if you can make a much larger profit without controls you are going to hold back for that.

The CHAIRMAN. I have no doubt that when we got to the teeter stage of decision in the matter that there might have been some speculative holding back. But we went into that with the greatest detail, we challenged the people that were in charge of the warehouses of this country to come forward with inventories showing hold-back and they did not come forward with any.

The people that you are talking for knew more about it than anyone else. There were some little speculative hold-backs. It (did not amount to a drop in the ocean.

Mr. SILBERSTEIN. We do know that while it was almost impossible to buy meat, because we were told that people just were not going to produce because of the controls that existed, as soon as they went off, the market was practically flooded and we have not had a shortage since.

The CHAIRMAN. The meat was there all the time and it was in the market all the time, but your people could not buy it. Is that the thing you want to go back to?

Mr. SILBERSTEIN. Are you suggesting they can buy it now?

The CHAIRMAN. They can buy it right now in any butcher shop they want if they will pay the price.

Mr. SILBERSTEIN, Yes.

The CHAIRMAN. Then they could not buy it, although they had the money in their pocket to buy it. Which is preferable, if you wait to eat meat?

Mr. SILBERSTEIN. I think that the situation today is that there are relatively few workers who can afford to buy meat as often as they could afford to buy it and actually get it, in the period of the war.

The CHAIRMAN. But you will admit it is easier to get now.

Mr. SILBERSTEIN. Yes; there is no question about that.

The CHAIRMAN. The meat was in full existence during the period of control, but it was not where the worker could buy it, even though he had the money in his pocket.

Mr. SILBERSTEIN. In the black market, you mean?

The CHAIRMAN. Now he can buy it and he has to pay more for it. Which is preferable, no meat, if you want meat, or eat it you get if you pay for it?

Mr. SILBERSTEIN. I think the black market accounted for an extremely small percentage of reduction and that workers were able to buy it, even during that period.

However, I wish to emphasize that none of this is really germane to the position we are talking. Fundamentally our position is extremely simple. I say on the one hand—

The CHAIRMAN. I am sorry to interrupt you, but I respect your viewpoints and I want to get the full benefit of them.

Mr. SILBERSTEIN. I greatly appreciate that.

The CHAIRMAN. I do not want to harass you with interruptions. Go ahead.

Mr. SILBERSTEIN. I would like to make very briefly what I believe is our central point. We have on the one hand a great mass of the taxpayers who, in a period of inflation, do not have a sufficient income to maintain a decent standard of living. And we say that to the degree that the Congress finds in its wisdom that reductions can be granted, the reductions should be granted to the people who are most in need of it, the people who do not have a decent standard of living under existing inflationary conditions.

That runs us into the problem of incentives.

The CHAIRMAN. That throws your whole economy on the basis of need; does it not?

Mr. SILBERSTEIN. We are not suggesting any change in the whole economy, but simply in this one sector.

The CHAIRMAN. A change would occur in your whole economy if you took the number of people that you are talking about and ran the whole economy on a strict basis of need. Would not that make a change in the economy?

Mr. SILBERSTEIN. I believe that it would not. Of course, if you did run your whole economy that way it would make an enormous difference. But we are not proposing that. We are dealing only with this one small problem and we think that pretty nearly everybody would agree that if you are able to give relief you ought to give it to the people who need it most, to the people who now suffer a hardship. And I am aware of the problem that I run into there.

We are told, as we heard this morning, that if you do not give relief and a lot of it, even more than you are giving now, there will not be incentives for production and that that is what we need most.

Now, that is the position with which we disagree. We believe that the main obstacle to investment is a belief on the part of potential investors that the existing situation is abnormal and unhealthy.

The CHAIRMAN. Are you going to make that potential investor, who comes out of the middle, and upper-income bracket, feel more confident about the system by putting more burdens on him?

Mr. SILBERSTEIN. No, sir; we are not suggesting that we put more burdens on him.

The CHAIRMAN. You said a while ago that one in the end would have to pay for the relief you are talking about.

Mr. SILBERSTEIN. No; I did not.

The CHAIRMAN. Then who would pay for it?

Mr. SILBERSTEIN. I said that instead of giving the reduction to him you would give it to the other person. He pays for it in the sense that he does not get something which now may be held out to him, but not that we are taking something away. I do not believe that these proposals encompass that.

The CHAIRMAN. If your problem is the need for the middle- and upper-income brackets to have some relief, and if the means of relief are available, and you do not give those brackets any of that relief, true, you are not giving them something which they had before, but are you exciting them to go out and patronize that kind of art system?

Mr. SILBERSTEIN. Sir, our view is that with ~~higher~~ profits that we now have, practically unprecedented in history, and dividends which are absolutely unprecedented in history, of 9½ percent, that certainly should be a sufficient inducement for any investor.

The CHAIRMAN. It is their take-home pay that counts, is it not?

Mr. SILBERSTEIN. That is their take-home pay, I mean after taxes.

The CHAIRMAN. All the testimony you heard today dealt with the take-home pay.

Mr. SILBERSTEIN. Sir, the issue is not on facts; the issue is, Why is it we do not have, if we do not have—and I do not know the answer to that, but I am accepting that that is so—why do we not have people investing in equities? They say it is because they do not get enough income.

The CHAIRMAN. For the very reason that you are mentioning, I suggest, that instead of giving them some relief at a time when the relief is needed to give incentive to investment, you want to make it tougher by making them make their burdens even more onerous.

Mr. SILBERSTEIN. I think that that is the essential point of disagreement. We believe that people hold back from equity investment; I know that I hold back and I am in a position to invest, because I feel that the situation we have today is unstable and unsound, and that we are moving toward a recession or a depression and I am not going to risk my money in that situation. I am going to put it in the safest place that I can have it in, generally that is in Government bonds.

Now, if we get over this inflationary period, we get some stability and we can see where we are going, of course I am not going to be content with that kind of a return. I am going to invest in equities. And I have had many clients that I have spoke to—

The CHAIRMAN. You are going to get over that by not relieving the middle and upper brackets and giving the relief that might be available entirely to the lower brackets?

Mr. SILBERSTEIN. I think, sir, that we can only get over that by stabilizing prices.

The CHAIRMAN. And reestablishing price controls.

Mr. SILBERSTEIN. By stabilizing prices and by taking such steps as we can to maintain purchasing power.

The CHAIRMAN. You think that will make these people in the middle and upper brackets tear their shirts into shreds and go out and make this productive machine work.

Mr. SILBERSTEIN. Sir, I am doing pretty well under these taxes and I know a lot of people who are in a similar situation. They are not suffering any hardship. I am certainly not suffering any hardship. I do not need any inducement to invest. All I want to know is that I will get a decent return. You assure me of a 5-percent return and I will invest mighty quickly.

The CHAIRMAN. You can go and get the bluest ribbon equities on a 5-percent return, if you will invest in equity. You beg the whole question.

Mr. SILBERSTEIN. I am not satisfied that that is true.

The CHAIRMAN. Will you say to me that putting your theory into effect will stimulate a new energy and a new hope and a new faith and a new chain of investment out of the people that can make the risk investments in this country?

Mr. SILBERSTEIN. I do believe, sir, that the only thing that will do that is to create in the minds of the people a feeling that we are moving along all right, we can see what our situation is going to be a year or two from now, instead of feeling, as they do now, that "I am very much afraid that a year or two from now we are going to be in a tailspin."

And we may be wiped out altogether. I think that is the real deterrent.

The CHAIRMAN. Your answer to my question is that by not giving these middle-income brackets and upper brackets any relief, assuming that relief is available, and putting it all in the lower brackets, that that will increase their incentives to go out and make this system work so you can get your money out of bonds and put them into equities?

Mr. SILBERSTEIN. Sir, I did not say that. I said that if we increase the purchasing power of the people in the lowest sector of our population that we will enhance the stability of purchasing power and minimize the danger of running into a recession or depression in the near future.

The CHAIRMAN. And you intend to achieve that by controls?

Mr. SILBERSTEIN. I am proposing nothing, sir, except that the relief which is given be given primarily, and to a larger extent than is provided, here, to the people at the lowest level.

The CHAIRMAN. I am trying to figure how you are going to make it good. You are going to make it good by restoring controls. And I assume that by some gimmick which you have not explained you will make those controls increase production.

How can the fellow that you are talking about have more if you do not produce more?

Mr. SILBERSTEIN. Well, sir, to the extent that things are now available, increasing purchasing power at the lowest income level will accomplish a redistribution from the people who have more now, more than they need, toward the people who have less than they need. And that, we think, is both morally and economically sound.

Now, of course, this alone is not going to accomplish the whole thing. That is acknowledged. You will have to have, also, an increase in production. And I think that that increase in production, growing out of stimulated capital investment, will come from a confidence in the economy rather than from getting another \$100 or another \$500. That is not going to mean anything to me, I assure you, Mr. Chairman.

The CHAIRMAN. I think you have stated your whole burden. You have to prove in your case here today that by doing what you propose to do you will increase production and stimulate confidence in our economy.

Mr. SILBERSTEIN. I believe that is true.

The CHAIRMAN. If you come up with that, you have produced the greatest contribution that has ever been produced in a tax hearing, and I am going to listen with my ears cocked and I will try not to interrupt you any more since we understand what your burden is here.

Mr. SILBERSTEIN. I must confess that what is in this paper is probably not going to fortify that greatly because this is not—

The CHAIRMAN. You have a lot in your head and if your paper does not fully express that we will give you the time to express it.

Mr. SILBERSTEIN. Thank you sir. This is not an economic document. As I recall, I was talking about the community-property provision.

The CHAIRMAN. Yes.

Mr. SILBERSTEIN. The split-income proposal is defended on the ground that it is necessary in order to eliminate the preferential tax position of the 12 community-property States in which, broadly speaking, the split-income system already exists. Several States have recently passed statutes adopting this system for tax reasons. We believe that this situation is an inequitable one, but it calls for precisely the reverse of the action proposed. What we need is not a provision allowing husbands and wives, in all States, to split their incomes but, instead, a provision requiring husbands and wives in all States to file joint returns. This proposal was urged by the Treasury in former years. In this way, the husband's and wife's joint incomes become the yardstick of ability to pay.

It is a reform badly needed to cut off tax avoidance and to adjust income taxes to the ability of the family unit to pay taxes. We deplore the proposal for income splitting as a highly regressive measure and a step in the wrong direction.

The CHAIRMAN. May I ask you how you would prevent the very rapid spread of the income splitting by the adoption of the community-property system?

Mr. SILBERSTEIN. Our tax authorities assure us, Mr. Chairman, that a law requiring all spouses to report income on a joint return would be lawful if special provision is made for credit for earned income in the case where a wife earns income.

The CHAIRMAN. I may refresh your memory; we tried it several times. The only difference with it is that you can not get the votes to make a law out of it.

Mr. SILBERSTEIN. That may well be true with a situation we have in the Congress today. But we are presenting our point of view from the aspect of principle. We think that if taxes are to be based on ability to pay, then the joint income—if the people live together, and only if they live together—should be reported as a single unit, because the income of both is available for the maintenance of that family unit.

The CHAIRMAN. You would not allow them, then, to have separate ownership of property?

Mr. SILBERSTEIN. Yes, they would be allowed to have separate ownership of property.

The CHAIRMAN. And separate control?

Mr. SILBERSTEIN. And separate control.

The CHAIRMAN. But if they had separate ownership and control, nevertheless you would tax them jointly?

Mr. SILBERSTEIN. We would tax them jointly if they lived together because the joint income is available to the family unit.

Economic considerations, as well as democratic and equitable principles of taxation, require the rejection of H. R. 4790. Our major internal problem is the skyrocketing cost of living. The Nation faces the calamity of boom and bust through the danger that prices will outrun the ability of our people to buy back the goods produced by our economic machine. Real wages have dropped. To keep purchasing power up and prevent a collapse, it is imperative that tax cuts be concentrated in the lower-income brackets.

On the other hand, the higher bracket taxpayers have fared very well indeed. Their incomes from investments have soared; corporate dividends are at their highest peak in history. Business profits and salaries in the upper brackets have climbed to new highs. These groups have excess funds to spend in the market place, which have contributed to inflationary prices. These groups are the Nation's large savers. High tax rates upon the upper bracket taxpayers serve two major purposes—

The CHAIRMAN. How do you like Mr. Truman's \$40 across-the-board bonus?

Mr. SILBERSTEIN. We are also opposed to that, sir.

To provide revenues required by the Government and to siphon off a portion of the large savings which, if uninvested may help plunge us into a depression.

We recognize the importance of encouraging the private investment of funds. High income-tax rates alone do not make investments unattractive. What the investor wants and needs is a steady flow of income and the safety of his investments, even at lower rates than sometimes been earned.

The CHAIRMAN. Did you notice the statement of the very high officials of this Government that the existing high rates, the very high and upper brackets are in fact all incentive to greater productive energy because a man has to work harder under those rates in order to live? Does that form any part of your theory?

Mr. SILBERSTEIN. I think not, sir. I do not think we could agree with that point of view.

The CHAIRMAN. As far as the lower brackets are concerned you would not advocate that?

Mr. SILBERSTEIN. No, sir.

This safety and security can be provided only by keeping mass purchasing power up; else the bottom will fall out of our economic boom, the value of investments will collapse and the market for new securities will be dried up. The key to the encouragement of investment is therefore the buying power of the average man and woman upon which a prosperous economy depends.

That, sir, I would like to emphasize is the heart of our position.

The CHAIRMAN. I do not care to debate that now, because that was the great central subject of debate all through the TNEC period.

Mr. SILBERSTEIN. That is right.

The CHAIRMAN. Do you not attribute any part of the necessary program to the need for capital goods as distinguished from consumer goods?

Mr. SILBERSTEIN. We acknowledge, sir, that there is a need for capital goods, but I think that in our present situation that is not the prime problem, except perhaps in relation to a foreign-relief program. I am not really sure of that.

The CHAIRMAN. Irrespective of the present situation, you have to have the machine and you have to have the pay roll; do you not?

Mr. SILBERSTEIN. Yes, sir.

The CHAIRMAN. So that some weight must be given to whatever tile factors may be required to get the machine. Is that not correct?

Mr. SILBERSTEIN. That is correct, sir.

The CHAIRMAN. Go ahead.

Mr. SILBERSTEIN. We are now discussing the President's program. The proposed \$10 reduction would have only a comparatively insignificant effect on the average taxpayer. For the more than 40,000,000 taxpayers with incomes under \$3,000 a year out of the total 52,000,000 income-tax payers the results would be approximately the same as if personal exemptions and dependency credits were increased from the present \$500 figure to \$700. These 40,000,000 people with incomes under \$3,000 are the bulk of the American people who are the hardest hit by the runaway prices. Their falling real incomes—falling because of rising prices—constitute the sword of Damocles hanging over our current boom and threatening to precipitate a collapse. This is an utterly inadequate program for dealing with our current problem.

The restoration of the wartime excess-profits tax, at reduced rates, with liberalized credits is in our judgment not the appropriate action to take under present economic conditions, nor is it the most desirable or effective method available for recouping any revenues which may result from tax cuts. We recommend, instead, the adoption of a graduated, corporate income tax.

The National Lawyers Guild calls for a program shaped to meet our most pressing need, namely, to reduce the tax load on the lower-income groups. To use taxation to shore up mass purchasing power and safeguard their threatened standard of living which is so basic to the American way of life, we propose the following program:

Personal exemptions: 1. We propose that personal exemptions be increased to \$2,500 for a married couple and to \$1,500 for a single

individual with the present exemption of \$500 for each dependent retained.

The CHAIRMAN. What would be the reduction in revenue?

Mr. SILBERSTEIN. I am afraid, sir, that I do not have that figure. I endeavored to get it, but the committee advised me that the Treasury base figures were not available on that.

The CHAIRMAN. Mr. Stamp estimates that will cost between eight and ten billion dollars.

Mr. SILBERSTEIN. I should like to emphasize, in connection with that, that while we have some proposals here for increased revenue by certain adjustments, we are not concerned primarily with the formula. We are concerned primarily with the principle.

In other words, if in the final adding up of the figures it is not possible to go that far, what we are saying, essentially, is that we think we should go as far in that direction as we possibly can and that this bill does not go nearly far enough.

The CHAIRMAN. There is quite a little theory in this bill in that direction. This bill would take six or seven million people off the rolls entirely. Back in 1948 we took 12,000,000 people off.

Mr. SILBERSTEIN. I understand that.

The CHAIRMAN. There is no harsh policy in Congress against taking people off by raising exemptions whenever it is felt that it can be done.

Mr. SILBERSTEIN. Sir, we believe that it can be done. In that connection, it should be recalled that during the period from 1925 through 1930 the exemption for a family of four ranged from \$3,300 to \$4,300.

The CHAIRMAN. How much revenue were we raising then?

Mr. SILBERSTEIN. I am afraid, sir, that I cannot answer that question.

The CHAIRMAN. We raised about six or seven billion a year. Now we are raising \$45,000,000,000 or something like that.

Mr. SILBERSTEIN. I understand that, sir. But in connection with those previous rates of exemption, it should also be recalled that an exemption

The CHAIRMAN. Do you not think everybody ought to be taken back to those idyllic days?

Mr. SILBERSTEIN. I think there might be certain advantages to that.

The CHAIRMAN. I think our minds are in complete agreement on that point.

Mr. SILBERSTEIN. We did have during that period the highest boom I think in 1929, prior to the present situation, even though in that period I understand that something approximating 90 percent of the revenue from taxes was derived from those taxpayers having an income above \$5,000 a year.

So that there is no necessary relationship between low exemptions and great inducement for capital investment.

The CHAIRMAN. If you are raising \$6,000,000,000 a year it is perfectly apparent that you can have lesser rates than if you have to raise \$45,000,000,000.

Mr. SILBERSTEIN. I understand that, sir.

We also propose that a discrimination existing against low-income groups in the treatment of exemptions be eliminated by Congress. As the law now stands, the benefit of exemptions increases as incomes rise, since exemptions are in substance a deduction from income. For

that reason, a married couple with two children having net income before exemptions of \$4,000 saves \$380 in tax by reason of the exemptions, 19 percent of \$2,000.

But the same taxpayer with a net income of \$25,000 saves \$1,180 in taxes, 59 percent of \$2,000, and if his net income were over \$150,000 he would save \$1,800, 90 percent of \$2,000. The administration's proposal recognized that this was an inappropriate method for handling exemptions by proposing a flat \$10-tax reduction for all taxpayers, instead of increased exemptions. We propose that the exemption for all taxpayers be equalized by deducting them from the lowest bracket. That would generally bring some added income.

Income-tax rates: The progressive increase of rates as incomes rise is a basic ingredient of a tax program based on the principle of taxation according to ability to pay. This principle is flagrantly violated under the present tax structure, because the lowest-bracket rates are crude and unrefined. They start at a very high level, 19 percent for the first \$2,000.

For the more than half, 26,000,000 of the American taxpayer, with net incomes, after exemptions and deductions, under \$2,000 a year there is no graduated rate. The \$2,000 of income taxed bears the same rate as the \$100 income tax. Both are at 19 percent. There is no warrant for discarding the graduation principle within this group of taxpayers. Moreover, for incomes after exemptions and deductions from \$2,000 to \$5,000, the rate goes up too rapidly to too high levels. Incomes, after exemptions and deductions of \$5,000 or more account for more than 95 percent of the American taxpaying population.

We propose to graduate the rates for the 6,000,000 highest bracket of our income-tax payers and to ease the burdens on the remaining 45 million who make up the American middle class. The rates should begin at a fraction of the current 19 percent for the first \$500 of taxable income and increase gradually in \$500 brackets, then in \$1,000 brackets to the \$5,000 level, with the rates in these levels lowered.

The CHAIRMAN. How about lowering that 19 percent a little? **Mr. SILBERSTEIN.** That is suggested, sir, by breaking it up. That is to say, start it at \$500 instead of \$2,000. Starting at a lower rate.

The CHAIRMAN. Instead of having your jump-off point at 19 percent, let us have it a little lower than that.

Mr. SILBERSTEIN. That is what is proposed, sir.

The CHAIRMAN. If the Congress should not go for this plan of yours, would you rather have something along the line of the Knutson bill rather than nothing at all?

Mr. SILBERSTEIN. I am not prepared to answer that question, sir. I think I had better not venture a view on that, because I have not considered it, and what I have tried to do is to present the view of my organization.

The CHAIRMAN. All right.

Mr. SILBERSTEIN. Mandatory joint returns: Husbands and wives living together should be required to file joint returns, with a special Credit allowed for working wives. In this way our income tax will more nearly approximate an ability-to-pay system and additional revenues will be raised.

The CHAIRMAN. Are you not deviating there somewhat from your main principle?

Mr. SILBERSTEIN. No, sir.

The CHAIRMAN. Why should not a working wife be allowed to make her own income-tax return?

Mr. SILBERSTEIN. Well, the basis of our recommendation, sir, is that the income is available for the family as long as they live together. And if our principle is ability to pay, then we should treat the income of both as the base to be taxed. And for Federal purposes we think it will be sound to base the tax on a joint return which would treat their joint income as one.

The CHAIRMAN. Why deviate from it? If you wish to give a credit to the working wife why not be consistent and give her the right to make a separate return of her income? She certainly is an independent entity to the extent of her earning power.

Mr. SILBERSTEIN. You mean with respect to her income? Her earned income? I see no reason why that would not be sound with respect to her earned income.

The CHAIRMAN. So that as far as earned income is concerned you are willing to have separate returns as distinguished from the joint return which you proposed?

Mr. SILBERSTEIN. I think personally that that would be all right. I do not know what our committee or what the organization would say about that.

That completes what we have in relation to income taxes. We do however, have some brief remarks in reference to corporate tax rates and excise taxes.

The CHAIRMAN. We are not dealing with that, but go ahead and give it to us.

Mr. SILBERSTEIN. Corporate tax rates: The Lawyers Guild favors the principle of graduated income-tax rates for corporations starting at 24 percent, reaching the current 38 percent at \$1,000,000 of net income, and graduating to a maximum rate of 60 percent for corporations with net incomes in excess of \$10,000,000. Smaller corporations should have the option of being taxed as partnerships. In view of the unprecedented level of corporate profits, this proposal would produce substantial additional revenues from corporations.

Excise taxes: Excise taxes, which are sales taxes under another name, are expected this year to yield 7.3 billion dollars in revenues, only 2 billion dollars less than the total income tax on all corporations. Levies on necessities bear heavily on the American standard of living. We believe that the excises on tobacco, beer, electrical appliances, admissions, and other items which are essential to the living standard of the people should be repealed and that the levies should be retained only on luxury items.

Tax policy is one of the major governmental instruments available to us in maintaining a high level of production and full employment and in safeguarding the American standard of living. Both the Republican-sponsored House bill and the administration's proposals fall far short of the needs of the times. If we are to prevent an economic debacle, we must use the taxing power to strengthen the weakening purchasing power of the American people, for that is the generator of prosperity; it is the key to high-level production, the foundation for security of investment in new and expanded business ventures and the essential requirement for an economy of full employment.

The tax program advocated by the National Lawyers Guild meets this all-important requirement of the immediate tax bill.

The CHAIRMAN. Thank you very much for coming and for your very interesting discussion.

Mr. SILBERSTEIN. Thank you, Mr. Chairman.

The CHAIRMAN. Mr. Foley?

Will you identify yourself for the reporter, please? Tell him your residence and business.

STATEMENT OF PAUL J. FOLEY, ATTORNEY, CPA, PAUL J. FOLEY & CO., CERTIFIED PUBLIC ACCOUNTANTS, CHICAGO, NEW YORK, AND WASHINGTON, D. C.:

Mr. FOLEY. My name is Paul J. Foley. I am an attorney and certified public accountant and head of Paul J. Foley & Co., certified public accountants of Chicago, New York, and Washington.

I wish to appear primarily in connection with the discrimination arising out of various of the community-property issues in H. R. 4790.

H. R. 4790 providing for splitting of couples' income seeks to perpetuate and compound the unconscionable discrimination against 8½ million heads of households comprised of 3,645,000 widows, 1,116,000 widowers, 707,000 divorcees, 1,120,000 separatees, and 1,036,000 unmarried heads of households. Census figures for April 1947, a representative period, reveal that although there are 30,545,000 married couples living together there will be 8,593,000 heads of households who cannot avail themselves of a share of the billion-dollar relief allowed couples.

Of greatest significance also is the fact that about 46 percent of the married couples have no children under 18 years of age. Specifically, in April 1947, of the 30,545,000 married couples above, 13,961,000, or 45.7 percent of such married couples, have no children under 18 years of age (Census report, series P-20, No. 11, February 11, 1948).

Less than 30 percent had two or more (Census Bureau Report, series P-20, No. 11, released February 11, 1948).

Obviously, therefore, the contention that the proposal will principally benefit parents is inaccurate, since it is common knowledge (see Census Bureau report, series P-60 No. 1 and related studies, that the reproduction rates are considerably lower than average in the very brackets which are most benefited by the splitting proposals.

On the other hand, there are 1,316,000 heads of families with their own children under 18 who would be deprived of any benefit or consideration under the splitting proposal since both parents are not present. In this group are, ironically, the widows and children of war dead.

It is generally conceded that parents rearing minor children should be given consideration in tax programs because from this group will come the future America whose health, spirit, and education may be adversely influenced by a tax structure which fails to give due regard to the parents' burden. However, it would be intolerably slovenly to provide relief in the amount of a billion dollars annually when more than... If will completely miss this mark and the distribution among those who ultimately benefit will be by chance rather than being based on any rational determination.

Moreover, it fails to provide for over $1\frac{1}{3}$ million individuals who are perhaps most deserving of consideration because they are caring for minor children without a spouse for help. Most typically the leads of such family groups tire carrying the complete burden on the very old or the very young, millions of whom would otherwise have to be institutionalized, most at public expense.

As just one example, under the proposed bill there would be many thousands of cases where the father of minor children would, after his wife's death, be deprived of her aid and companionship at the very time that his Federal taxes would be increased in 10 percent because he no longer is in the favored group.

It is recognized that in this broken-family group conditions are most conducive to juvenile delinquency and truancy, against which the head must battle at time when he must buy services which would otherwise be performed by his spouse. In all strata of our society, such a head of family deserves the consideration and aid, or frequently sympathy, rather than the discrimination and abuse which this bill heaps upon him.

The second group against which the discrimination is sought to be perpetuated is the lower-bracket taxpayers in general. The married couples who would actually benefit are a small minority. Of the \$1,045,000,000 annually involved in this splitting, 96 percent of all tax-paying couples would get only about 50 million in savings, while practically 1 billion would go to the remaining 4 percent of taxpaying couples.

In fact, the actual amount of benefit, if any, is the result of sheer chance resulting from the irrational basis of the exit to which the tax on a couple's income is more than double the tax on half of it.

The effect of this formula is illogical, inequitable, and certainly not predicated on ability to pay. It substitutes for a planned reduction for each bracket the vagaries of a ruthless mathematical formula which gives phenomenal savings to some few couples.

The fourth group comprised of other single people is discriminated against because in all future legislation rates will have to be high enough to get a reasonable yield from the favored group, with the result that tax rates on the single will be prohibitive.

The first question which comes to my mind is why has not something been done about this on the Federal level before now. The history of legislative attempts to eliminate this discrimination resulting in a community-property treatment of a couple's income extends over a period of 25 years. Rather than there being any recent, concerted, and sincere effort to eliminate the basis discrimination, the correctives have become commingled with proposals aimed at tax treatment of family incomes, generally through mandatory joint returns.

It is against this muddled background that the present legislation is proposed. This indicates the many obvious reasons why this long list of attempts has failed in enactment of a corrective. However, it can be categorically charged that in the last 20 years no House committee or Treasury sponsored bill has been directed against the definite and obvious objective which justice demands, namely, elimination of the discrimination in the particular community-property situation, as to dividing couples' incomes, as it stood then and now exists.

For purposes of political strategy, academic theory, and similar reasons the issue has recently been muddled with ~~the~~ ^{the} ~~problem~~ ^{of the problem}: ~~whether to tax~~ ^{of the problem} ~~community property~~ ^{of the problem} ~~States~~ ^{of the problem} ~~and non-community property~~ ^{of the problem} ~~States~~ ^{of the problem} ~~it is not necessary~~ ^{of the problem} ~~to demand mandatory joint returns,~~ ^{of the problem} ~~as this raises a host of issues not~~ ^{of the problem} ~~at all involved in elimination of the present discrimination of the~~ ^{of the problem} ~~law as between residents of various States.~~ ^{of the problem}

To eliminate the discrimination between community-property States and non-community-property States it is not necessary to demand mandatory joint returns, as this raises a host of issues not at all involved in elimination of the present discrimination of the law as between residents of various States.

Every time the mandatory joint return issue has been raised, *hosts of gold-plated suffragettes* have descended upon Congress to reenact their epic drama regarding married women's rights, and *ladies* that all will be lost if ever a wife must file a joint return with her husband and thereby again be subjected to economic slavery. The real issues

being thereby muddled, various moralists and isolated church groups joined the little and a deafening thunder of cries about marriage, morals, economic serfdom, and the like killed any further relevant determination or any action.

Consideration should be given to the fact that the adoption of the Splitting policy will inject into the tax structure a factor which will be difficult if not impossible to remove because of political considerations and yet will confuse and be troublesome in all future determinations of rates for various brackets since an alternative rate is available to some taxpayers, but not all, in some, but not all, brackets.

It seems inevitable that the future rate for each of the brackets affected would have to compromise which will thrust too much on those who cannot avail themselves of the alternative calculation and too little on those who can.

During the recent House hearings on the present bill the advocates of community property favoritism further beclouded the issue by emphasizing alleged discrimination against community-property States enacted in the Revenue Act of 1942 (aff. sees. 811D, 811E, and 811G of the code) as to transfers of community property in contemplation of death, and the inclusion in many cases of the entire Community interest in the estate of decedent.

It is noted that the present bill in sections 351 through 354 repeals the 1942 enactments. The provisions of Revenue Act of 1942 were intended to put residents of all States on an equal footing as to Federal estate taxation.

The present bill would repeal the 1942 enactment. Again this is done without ever attempting to retain that which would provide most equality for all States. Indeed the repeal will give a favored status of estate taxation far more significant than the slight imperfections of the present law.

The foregoing is mentioned because it was stressed at the House hearings and appeared to greatly confuse the issues on income tax. Actually it is, of course, only collateral to the income tax issue since the only sound basis can be that of providing, as well as possible, Federal tax laws of both type which are identical in dollar impact on residents of all States.

Many misleading, unfounded, and rash statements have been made to the effect that it would be unconstitutional to amend the code so as to tax income to the earlier. Uninhibited imagination and fanciful theory was displayed at the House hearings. One witness even con-

tended that it would be unconstitutional to tax a community property State husband on his wife's share of his earnings, although it would be constitutional to determine his tax rate on the basis of the wife's share being added. Most of these claims of constitutional limitations call be dismissed as being so blinded by fragmentary technicalities that all perspective of the real issues is lost.

It is impossible any longer to contend that division of community income on separate returns has a constitutional basis. It is clear that Congress could treat community income as the income of the earner, or in case such income is derived from community or separate property, as the income of the earner or owner of the property, respectively.

As already observed above, the community property income tax cases decided in 1930 (*Poe v. Seaborn*) which sustained the income tax treatment now in effect in community property States, resulted from judicial sleight-of-hand and from statutory rather than constitutional interpretation. Such constitutional references as they contained were indirect and at best only dicta; the constitutional problem was not in issue.

So that as it may, in the community property estate tax cases (*Fernandez v. Wiener*, 4502 U. S. T. C. 10, 239, 6 S. Ct. 178), decided in 1945, the Supreme Court made it clear that Congress was not bound by any ancestral notions of ownership in determining whose is what for the purpose of taxation. In the face of those cases it would be absurd to say that Congress could not use the "managerial" powers of the husband as a basis for taxing to him the entire income earned by him though half of it under local law is tagged—in a suspended sort of way—as the "vested" interest of the wife, or that Congress could not use the receipt and actual control by the earner, be it husband or wife, as a basis for taxing to the earner the income earned by him.

The CHAIRMAN. Passim: the power of Congress to enact that kind of law, the community property in those States where it exists is a real reality. If you do not believe so, just watch what happens when you have a divorce or death.

Mr. **FOLEY.** Senator, the observation on that vesting seems to be that the husband has complete control of it, and the only time when it does have a different status is at such times as the wife might be able to prove that the husband was using it in a defrauding sort of way or at times when the marriage is being split either through death or divorce action.

The CHAIRMAN. The split income follows split ownership.

Mr. **FOLEY.** Sir, it is in my mind rather immaterial as to what the tag is in local law when, under all of these local laws, the husband has the right to control and use the entire proceeds irrespective of the union or interest of the wife, anything short of being defrauding of the wife.

The CHAIRMAN. I understand your theory of it completely. But the fact of ownership of property and the fact of rights of enjoyment are rather important facts to be considered. I think your theory waves that all out and puts the tax on control exclusively.

Mr. **FOLEY.** Mr. Chairman, as to income and moneys which are currently expended, it seems that the only real determination that is of any merit is the right to spend it, and the control of it. If we are

thinking of a corpus of community property accumulated, that, of course, presents a different issue, but when it comes down to the money which is currently coming in and going out, the rights, as I see it, fall on the person who has the right to control it and spend it.

The CHAIRMAN. If you are eating that which is channeled to you by the person who has the control, you are enjoying the benefit from it, are you not?

Mr. FOLEY. Yes, sir. And I might point out that in practice I have not observed too much of a difference among the household activities of the residents of common-law and community-property States in this respect.

The CHAIRMAN. I think you are quite right on that.

Mr. FOLEY. Each seems to conduct its own household funds on the same basis.

The CHAIRMAN. If you can jump the bridge of wiping out the incident of ownership, you can argue along the line that you are arguing.

Mr. FOLEY. That gap has been pretty well bridged in the Wiener case by the Supreme Court in 1945, which, of course, was an estate-tax case. But the constitutional issues in there, as to ownership and the right to control, as I see it, are basically the same as would be raised in an income-tax case.

The CHAIRMAN. I think control may not be a necessary factor, but it is an important factor in weighing who really has this income. I do not think there is any question about that.

As I gather from your testimony, you are putting almost exclusive weight, giving almost exclusive weight, to that factor.

Mr. FOLEY. What I am pointing out, Senator, briefly, is this: This bugaboo about a constitutional issue has been one of the things which has prevented the elimination of this community property splitting when it possibly should have been stopped before it got such popular acceptance and has resulted in the legislatures of the various States trying to get onto the band wagon. It would inject into our tax structure a very irrational concept. The irrationality of it comes about because instead of a planned determination of the amount of reduction of rate that would be applied in each bracket, it is left wholly, entirely to the functioning of a ruthless mathematical formula.

I have no quarrel whatsoever with the division of the reduction of income between the high or the low. It is completely irrelevant to this issue, but when you look at the amount of percentage reduction in income tax for each bracket, which does come about because of this, and it plots like a mountain peak, you realize that the whole concept of it is rather irrational. It is not plotted according to any particular Scheme of things.

Why should a man—just to pick at random—why should a man at 50 thousand get so much lower percentage reduction than at 25 thousand, and why should a man at 15 thousand income get so much less than a man at 25? Wholly apart from the issues as to who should get it, it thrusts this particular issue: You are giving out, in effect, a billion dollars in potential tax relief without a rational determination of who, among the various brackets, should get it.

The CHAIRMAN. I may say that I developed many of the points that you are discussing so ably here today, in the Senate a year ago. But the sentiment for splitting income seems to have continued very strongly.

Mr. FOLEY. I think, if my observations are correct, that much of the fervor for splitting of income is predicated upon the misapprehension that all families are going to benefit from it, and many people who will not ultimately benefit are actually of the opinion that they will.

Also, I would like to point out one basic fallacy, as I see it. As we look back into the Roman law and the history behind this community-property thing, we see one basic change. In our modern economies the modern households are getting smaller, and they are getting different types of composition. The result of that is that in being smaller there are fewer of them that have the perfect structure of having a married couple, that is the head of the household being married and having his wife present, a requisite for this particular reduction. We must now consider it on a family rather than a couple basis.

Actually what is most important is the fact that we must recognize that it is the head of the family who is carrying the burden in our present economy in about 25 percent of all households, this head of the family not being married and living with his wife at the time, at least, and it means that the concept of the head of the household be substituted as I see it, for head of the household.

The CHAIRMAN. Do you not think that this enormous working force that we have at the present time has brought many women into the labor market with the result that it has increased the independence of women in the household to that extent?

Mr. FOLEY. Perhaps that is true. I have no doubt that it is. But the tile injustice comes out in such cases where a head of a household, in this instance a million and a third of them who are still rearing their own minor children, who would have all the burdens of any husband, and more, and would get no consideration under this particular splitting determination.

Now, if I may just anticipate myself, there are two alternatives. One would be better than the other, but either would be better than the present situation. It would be possible to have a head-of-family class, and permit him to have the same status for purpose of splitting as the couple would enjoy, or, of course, it would be possible to abrogate the community-property income splitting.

But it seems that most of the actual difficulties have not been gone into very much because the people who have been getting it to date have looked upon it more or less as a gift and have not complained of any of its defects.

In continuing, I was going to point out that the Tower and Lusthaus case and others have indicated very clearly a trend demonstrating that it would be constitutional for the Congress to actually abrogate the splitting of income in the community-property States.

The CHAIRMAN. The difficulty is that it is not a novel thought. It has been tossed in the hopper around here a number of times.

But legislatively it has not been possible to do it.

Mr. FOLEY. While it might be legislatively impossible to do that, Senator, I would like to urge at least that the head of household be given some consideration.

I would like to point out that in the various studies that have gone into the House hearings so far, I saw no indication of the large number that would be involved. So I have dug up the figures on the number that would be involved and it is very amazing, at least to me, that this large group would be involved and left in the cold.

And having all the responsibilities and cares of a couple, they certainly ought to be given every consideration that a couple has been given.

Except for the conclusion, which more or less has been covered by what I have anticipated, that concludes my testimony, Senator.

The CHAIRMAN. Thank you very much for coming. Your testimony has been very interesting.

Mr. FOLEY. Thank you, sir.

The CHAIRMAN. The hearing will recess until 10 o'clock Monday morning.

(Thereupon, at 3:45 p. m. the committee adjourned, to reconvene Monday, March 8, 1948, at 10 a. m.)

REDUCTION IN INDIVIDUAL INCOME TAX

MONDAY, MARCH 8, 1048

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

The committee met at 10:10 a.m., pursuant to adjournment, in room 312 of the Senate Office Building, Senator Eugene D. Millikin (chairman of the committee), presiding.

Present: Senators Millikin, Brewster, Martin, George, Barkley, Connally, Johnson, and Lucas.

Also present: Senator Overton.

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

Mr. Schoeneman, we are glad to have you here this morning. Will you state your full name.

STATEMENT OF GEORGE J. SCHOENEMAN, COMMISSIONER OF INTERNAL REVENUE, BUREAU OF INTERNAL REVENUE, WASHINGTON, D. C.

Mr. SCHOENEMAN. My name is George J. Schoeneman.

The CHAIRMAN. And your business?

Mr. SCHOENEMAN. Commissioner of Internal Revenue.

The CHAIRMAN. Will you proceed, Mr. Schoeneman, please.

Mr. SCHOENEMAN. Mr. Chairman and members of the committee, I appreciate the opportunity to comment on the administrative aspects of H. R. 4700.

At the outset, I should like to make it clear that it is not within my province as Commissioner of Internal Revenue to discuss whether there should or should not be a tax reduction. But as Commissioner I am responsible for all management processes required in the administration of revenue legislation, and in this capacity the Bureau considers itself the servant of the individual taxpayer as well as the Government's tax-collecting agency.

Effect of the bill on the number of tax returns: Secretary Snyder has advised you that the various provisions of H. R. 4700 would remove some 6.3 million taxpayers from the tax rolls. This does not mean that the number of tax returns would drop 6.3 million. Actually the total decrease in the number of returns required to be filed as compared with present law would be 2.8 million.

The CHAIRMAN. How many taxpayers would it take from the roll?

Mr. SCHOENEMAN. 6,300,000.

The CHAIRMAN. You mean 6,300,000 people who are paying taxes now would not pay taxes?

Mr. SCHOENEMAN. That is right.

The CHAIRMAN. But a certain number of those would nevertheless be filing returns; is that the point?

Mr. SCHOENEMAN. That is right.

The smaller decrease in number of tax returns than in number of taxpayers results in part from the fact that returns are required even though they are nontaxable in those cases where the gross income exceeds the filing requirement but is offset by such items as business expenses, deductions, and exemptions. In addition, we normally get several million nontaxable returns that have the character of claims for refund, because the annual income of a person may be below the filing requirement but wages for one or more pay-roll periods during the year are of sufficient size to require the employer to withhold tax.

Without any change of law we estimate a total of 56,000,000 individual income-tax returns will be filed for the tax year 1948. This compares with 55 million for the tax year 1947 and 52.8 million for the tax year 1946.

The CHAIRMAN. Is this increase due to increased income?

Mr. SCHOENEMAN. Yes, sir; and added number of income receivers.

The CHAIRMAN. Proceed.

Mr. SCHOENEMAN. Therefore, it will be observed that even after effect is given to the change in filing requirements under H. R. 4790, we will still have a larger volume of returns for the tax year 1948 than for the tax year 1946.

Importance of the tax form in tax administration: As I stated to the Ways and Means Committee, the Bureau of Internal Revenue in its role as administrator of the tax laws represents you in interpreting these laws for the people. Practically the entire wage-earning and income-receiving population is affected by the bill before you, and relatively few of these people ever read the law. To them the tax return with the accompanying instructions which the Bureau places in their hands is the law. That I think, is as it should be.

It is because the income tax blank is such an important instrument in translating the law into revenue collections that we have placed so much emphasis upon its appearance and content; and that interest has been shared by your committee.

Items which will present difficulties for the taxpayer and the Bureau: Some of the provisions of H. R. 4790 will not create any additional compliance problems. Others will eliminate some of the problems under present law. There are, however, four problems affecting principally the low-income groups which are certain to cause difficulty from the compliance standpoint, both with regard to taxpayer reaction and efficiency and economy of operation.

The four problems relate to:

- (1) The method of the rate reduction;
- (2) The introduction of three rates of tax on the first \$2,000 of taxable income as compared with one under present law;
- (3) The split-income provisions—I am not referring here to the general split-income provision but to the effect of split income coupled with the division of the first surtax bracket—and
- (4) The lack of correlation between the final tax liability and withholding, and the additional withholding rate applicable to employers using the percentage method of withholding.

The above items are interrelated, and I would like to enumerate rather briefly the specific problem which will arise under them. To

aid in visualizing these problems, portions of the forms materially affected by them have been drafted. A comparison of these drafts with the corresponding portions of the present law forms is shown in exhibits A, C, and D.

Manner of effecting rate reduction: H. R. 4790, in effect, provides a rate reduction by reducing the tentative tax computed under present law normal tax and surtax rates. A comparison of the tax computation schedule from page 3 of the present Form 1040 and the schedule which would be required under H. R. 4790 if the percentage reductions are set forth on the return is shown in exhibit A. This method of rate reduction is probably a carry-over from H. R. 1. Originally, as you will recall, a straight ~~across-the-board~~ rate reduction was planned.

The bill before you, however, grants tax reductions by several devices other than the percentage reduction. There is the increase in exemptions, the ~~split-income~~ provision, the special exemption for the aged, and others. Less than ~~one-fifth~~ of the over \$6,000,000,000 reduction would actually appear in the form of reduction in tentative tax in accordance with percentages prescribed by the bill. Let us look for a moment at the taxpayers who will see this reduction and how it will appear to them. Some 23,000,000 returns will be filed on Form W-2, and the filers of these returns will not see the percentage reductions. About 21,000,000 returns will be filed on Form 1040 and the tax will be determined from the Supplemental T tax table. Again, these return filers will not see the percentage reduction, so that only the filers of some 9,000,000 returns will be troubled with these percentages and will see the dollar reductions in the tentative tax.

I believe that they are likely to be confused by what they see. Let us take the case, for example, of a married person with a wife and child whose net income is \$2,000. The tax liability under present law is \$95, the tax liability under H. R. 4790 is \$26.60, a decrease of \$68.40 or 72 percent. Under the mechanics prescribed by H. R. 4790, the return of this couple would show a tentative tax of \$40, and a reduction of tentative tax of \$13.40 or 33 percent. It would seem to me that setting forth this percentage reduction on the return would serve only to confuse the couple into thinking they had received a tax reduction of \$13.40 when the actual reduction is \$68.40.

The CHAIRMAN. Of course, as a practical matter, they would have the comparison between what they paid under the proposed law and what they paid under existing law, and the difference would not escape their attention, would it?

Mr. SCHOENEMAN. I believe in this method one portion of the reduction would be emphasized, but the balance of it would be rather hidden.

The CHAIRMAN. Your point is clear, but I am wondering in practical effect whether the taxpayer who put out \$95 at the present time and would wind up on his next return putting up \$26.60 would be unconscious of the difference between the two, and would think that he had only a reduction of \$13.40.

Mr. SCHOENEMAN. I think, Mr. Chairman, if his income for the previous year and 1948 were the same, he would be conscious of it; but if there was a change in income, I do not think that with the 1947 bill before him—that is, the bill in effect in 1947—he would be conscious of it.

I think his attention would be directed to the smaller item which is shown on the rate schedule.

The **CHAIRMAN**. We certainly wish him to be conscious of the reduction.

Mr. **SCHOENEMAN**. Let us take just one more case—a married couple with \$10,000 net income—and see what impression the percentage on the return would give them. Under present law, the tax liability is \$2,185; under H. R. 4790 the tax liability is \$1,454.64, a reduction of \$730.36 or 33 percent. If the percentage reductions prescribed by H. R. 4790 are set forth on the return, this couple would compute a tentative tax of \$1,888, and reduce it by \$433.36 in arriving at their final tax. Thus of the actual tax reduction of \$730.36, only \$433.36 would be reflected in the percentage reduction.

While it is true that no single return is affected by more than one of the several formulas, the problem is to get taxpayers to choose the correct formula. This percentage-reduction formula, if provided on the return, will serve only as a stumbling block and a source of mathematical errors by taxpayers, increasing the verification job for the Bureau.

We have developed a combined normal tax and surtax schedule which reflects the percentage reductions of H. R. 4790 and which provides the same amount of tax as the roundabout method described above.

While this method is simpler than that provided by the bill, it is rather cumbersome since it involves a peculiar break within the first surtax bracket and involves rates which are not in even percentages. It would also be necessary to accompany this schedule with complicated rules for use by taxpayers with partially tax-exempt interest.

The **CHAIRMAN**. Are you referring to your own schedule, or what you would have to do under this bill?

Mr. **SCHOENEMAN**. No, sir; our own schedule. That would have to be described in some way to take care of that partially exempt interest.

The **CHAIRMAN**. Proceed.

Mr. **SCHOENEMAN**. The combined normal tax and surtax schedule is shown in exhibit B as it might appear on Form 1040. Let me assure you again that this schedule will produce precisely the same tax liability in each individual case as would the percentage reduction as shown in exhibit A. For example, assume a surtax net income of \$1,000. Under the percentage method prescribed by the bill a tentative tax—20 percent of \$1,000 or \$200—would be computed and reduced by 33.5 percent, or \$67, leaving a tax liability of \$133. Under the combined rate schedule as shown in exhibit B, the \$133 tax liability would be computed by applying the 13.3 rate directly to the surtax net income. We believe this makeshift schedule is the lesser of the two evils.

Two Supplement T tax tables: Due to the income-splitting provisions, the tax liability for incomes under \$5,000 can no longer be determined merely by referring to the total number of exemptions and the amount of adjusted gross income. To illustrate, today the tax liability applicable to an adjusted gross income of \$2,500 is the same for—

- (1) A single person with one dependent;
- (2) A married person filing a separate return and claiming an exemption for a dependent child; /

(3) A carried person with no dependents filing a separate return and claiming an exemption for himself and his spouse; and

(4) A husband and wife with no dependents filing a joint return.

Under H. R. 4790, however, the tax liability for the first three classes of returns is the same, but this liability differs from the tax liability for the last class of returns, necessitating two Supplement T tables instead of one table as at present. A comparison of the Supplement T tax table from page 4 of the present Form 1040 with the two tables required under H. R. 4790 is shown in exhibit C.

The additional Supplement T tax table prescribes a smaller tax in the case of joint returns with incomes of \$2,450 or more and two exemptions; \$3,100 or more and three exemptions; \$3,800 or more and four exemptions; and \$4,450 or more and five exemptions. Dividing the first surtax bracket into three parts is responsible for the slight differential at the \$2,450 income level. If the present \$2,000 bracket were retained, no differences would occur below \$3,500.

The Bureau and the taxpayers have had no actual experience with a tax return form that incorporated more than one Supplement T tax table. You will recall, however, that the Revenue Act of 1943 prescribed multiple Supplement T tables. At that time the Bureau conducted tests with a number of forms carrying these tables. These tests and our general experience with taxpayer problems give me ample reason to fear the consequences of such a form.

Problem of differentiating as between joint and separate returns:

As you know, there is a technical distinction between:

(a) A separate return of a husband who claims an exemption for his wife who has no income or deductions; and

(b) A joint return of husband and wife where the wife has no income.

In the former case, only the husband signs and is liable for the tax. In the latter case, both spouses sign and they are jointly and severally liable for the tax.

Since in our present law there is no tax differential as between the two types of returns, it is not customary in the case of returns with only one income earner for both husband and wife to sign. Since under H. R. 4790 split-income benefits are restricted to "joint" returns, requiring the signature of both husband and wife, it becomes a matter of importance that the signature be correctly affixed. Based on present practice there is not much question but that hundreds of thousands of returns will be filed without the proper signature and much correspondence and taxpayer irritation will result.

The two supplement T tables and the problems concerned with signatures are particularly disturbing in connection with Form W-2 returns. These are the returns on which the collectors compute the tax for the taxpayers. There are roughly 24,000,000 returns filed on Form W-2 each year.

The method of determining the tax on these forms is largely a matter of sorting the returns by number of exemptions and by amount of adjusted gross income, the tax on each common group of returns being the same.

Under H. R. 4790, however, an additional classification of returns will have to be made, namely, the joint returns will have to be determined from the separate supplement T table. While this problem is by no means small, the problem which concerns me most is the

distinction as between a "joint return" and a "separate return of husband or wife showing exemptions for both spouses where one spouse has no income." Technically the matter of signatures creates two important differences:

First, it determines which tax table will be used in computing the tax; thus the tax on a joint return, signed by both, will in many cases be less than the tax on a separate return.

Second, it determines whether the tax liability applies to one spouse only or is joint and several, and whether the refund check or bill would be addressed to both husband and wife or to only the person signing the return.

If we take the statute literally and compute the tax for all separate returns from the separate return table, we undoubtedly will be depriving some taxpayers of certain tax benefits to which they are entitled. The alternative to this is to send these unsigned returns back to taxpayers and invite the wife's—or husband's—signature. As previously indicated, this will impose considerable burden upon the collectors' offices and create taxpayer irritation.

If this were a problem affecting only a few hundred or even a few thousand cases, I would not have burdened you with a discussion of it. But since it is a problem involving literally millions, I feel obliged to point out that in this respect H. R. 4790 would create a serious administrative situation.

The problems of withholding: Under present law withholding by either the table or percentage method is carried through two surtax rates, or \$4,000 of surtax net income. This means that for surtax net income of less than \$2,000 employers using the percentage method need apply only one withholding rate, while for surtax net incomes of more than \$2,000 two rates are used.

Under H. R. 4790, however, three rates are prescribed in the percentage method. As compared with one under present law for surtax net incomes between \$1,000 and \$1,395.85, H. R. 4790 prescribes two; as compared with one under present law for surtax net incomes between \$1,395.85 and \$2,000, H. R. 4790 prescribes three; as compared with two under present law for surtax net incomes above \$2,000, H. R. 4790 prescribes three. See exhibit D for a comparison of the percentage method of withholding under present law and under H. R. 4790.

Despite the prescription of as many as three separate withholding rates, as compared with a maximum of two under present law, H. R. 4790 does not provide as much correlation between withholding and liability as does present law. That is, withholding under H. R. 4790 is carried at full liability rates only through \$2,000 surtax net income, since withholding through \$4,000 would require four distinct rates in the percentage method and would be too complex. Above \$2,000 surtax net income, tunder withholding occurs for single persons and married persons filing separate returns, resulting in balances of tax to be paid at time of filing. The balances which may result from not carrying withholding at full liability rates through \$4,000 can be as much as \$30.

On the other hand, since it would be very burdensome for the employer if provision for split income is made in the withholding system and is added to the problem of three rates, married persons will not get the benefit of split income in their withholding, and overwithholding of as much as 14 percent for such persons occurs for surtax net incomes

between \$1,000 and \$2,791. Above \$2,791 the effects of tile elimination of the fourth rate and of disregarding income splitting for withholding purposes are more or less compensating.

Under H. R. 4790, a greater amount of overwithholding will occur for single as well as married persons in the case of wages fluctuating between surtax brackets, since the income level at which graduation begins is lowered from \$2,000 surtax net income to \$1,000.

Simplification measures: Our joint record in the furtherance of simplified tax forms is a good one. This is evidenced by the Individual Income Tax Act of 1944 in which certain major simplification devices were adopted; namely, the per capital exemption system, the standard deduction, and improved Supplement T tax tables.

Much of the over-all progress that has been made will be undone as a result of the bill before you for the reason that the first bracket is being broken in three parts, which, when coupled with the split-income provisions, results in two Supplement T tax tables rather than tile present one; results in three withholding rates rather than the present two; and results in the collectors being faced with the ramification of the split-income provisions in connection with the computation of the tax for the taxpayers on Form W-2.

Every effort should be made to achieve further simplification rather than further complication, especially for the taxpayers in the lower groups, as a means of encouraging rather than discouraging voluntary compliance with tile tax laws.

I earnestly urge that consideration be given the provisions which I have pointed out as responsible for these difficulties before this bill is passed.

In this connection I would like to assure you that now, as at all times, our technicians stand ready to assist you and your staff in any manner possible to further our joint simplification interests.

(The exhibits referred to are as follows:)

EXHIBIT A

Present Tax Computation Schedule from Page 3 of Form 1040

TAX COMPUTATION--FOR PERSONS NOT USING TAX TABLE ON PAGE 4

1. Enter amount shown in item 6, page 1. This is your Adjusted Gross Income.....
 2. Enter DEDUCTIONS (If deductions are itemized above, enter the total of such deductions; if adjusted gross income (line 1, above) is \$5,000 or more and deductions are not itemized, enter the standard deduction of 300).....
 3. Subtract line 2 from line 1. Enter the difference here. This is Your Net Income.....
 4. Enter your tax payments for the year (Enter the person whose name is listed in item 1, page 1).....
 5. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount entered on line 3. Enter the tentative tax here (if line 3, above includes partially tax-exempt interest, see Tax Computation Instructions).....
 6. Enter here 3 percent of amount entered on line 3, above.....
 7. Subtract line 6 from line 5. Enter the difference here. This is your combined normal tax at surtax. (If alternative tax computation is made on separate Schedule D, enter here tax from line 12 of Schedule D).....
- IF YOU USED THE \$100 STANDARD DEDUCTION IN LINE 2, DO NOT DUPLICATE LINES 2, 10, AND 11, AND COPY ON LINE 1 THE SAME FIGURE YOU ENTERED ON LINE 8**
8. Enter here any income tax payments to a foreign country or U. S. possession (attach Form 1118).....
 9. Enter here any income tax paid at source on tax-free covered bond interest.....
 10. Add the figures on lines 8 and 9 and enter the total here.....
 11. Subtract line 10 from line 7. Enter the difference here and in item 7, page 1. This is your tax.....

Tax Computation Schedule Required under H. R. 4790

TAX COMPUTATION—FOR PERSONS NOT USING TAX TABLES ON PAGE 1

- 1. Enter amount shown in Item 6, page 1. This is your Adjusted Gross Income \$
2. Enter DEDUCTIONS (if deductions are itemized above, enter the total of such deductions; if adjusted gross income (line 1, above) is \$5,000 or more and deductions are not itemized, enter the standard deduction—See Tax Computation Instructions)
3. Subtract line 2 from line 1. Enter the difference here. This is your Net Income
4. Enter your exemptions (\$500 for each exemption claimed in Item 1, page 1)
5. Subtract line 4 from line 3. Enter the difference here
Lines 6, 7, and 8 should be filled in ONLY by a single person or a married person making a separate return.
6. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount on line 5. Enter the tentative tax here (If line 3, above, includes partially tax-exempt interest, see Tax Computation Instructions)
7. (a) If amount entered on line 6 is not over \$200, enter 33 1/2% of that amount here
(b) If amount entered on line 6 is over \$200 but not over \$279.17, enter \$67 here
(c) If amount entered on line 6 is over \$279.17 but not over \$840, enter 24% of that amount here
(d) If amount entered on line 6 is over \$840, enter \$201.60 plus 14% of the excess over \$840 here
8. Subtract line 7 from line 6. Enter the difference here
Lines 9 to 11 should be filled in ONLY if the tax is a joint return of husband and wife
9. Enter here one-half of amount on line 6, above
10. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount on line 9. Enter the tentative tax here (If line 3, above, includes partially tax-exempt interest, see Tax Computation Instructions)
11. (a) If amount entered on line 10 is not over \$200, enter 33 1/2% of that amount here
(b) If amount entered on line 10 is over \$200 but not over \$279.17, enter \$67 here
(c) If amount entered on line 10 is over \$279.17 but not over \$840, enter 24% of that amount here
(d) If amount entered on line 10 is over \$840, enter \$201.60 plus 14 1/2% of the excess over \$840 here
12. Subtract line 11 from line 10. Enter the difference here
13. Multiply amount on line 12 by two. Enter the result here
IF YOU WANT THE STANDARD DEDUCTION IN LINE 2, DISREGARD LINES 14, 15, AND 16, AND COPY ON LINE 17 THE SAME FIGURE YOU ENTERED ON LINE 8 OF 13
14. Enter here any income tax payments to a foreign country or U. S. possession. (attach Form 1116)
15. Enter here any income tax paid at source on tax-free covenant bond interest.
16. Add the figures on lines 14 and 15 and enter the total here
17. Subtract line 16 from line 8 or line 13, whichever is applicable. Enter the difference here and in Item 7, page 1. This is your tax

EXHIBIT B

Rate and Computation Schedules of Reduction Formulas Under H. R. 4790 Are Shot on Form

RATE SCHEDULE

Table with 2 columns: 'If the amount on line 5 is:' and 'Enter on line 6 or line 10:'. It lists tax rates for various income brackets from \$2,000 to over \$150,000.

COMPUTATION SCHEDULE

5. Subtract line 4 from line 3. Enter the difference here. \$.....
6. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount on line 5. Enter the tentative tax here. (If line 3, above, includes partially tax-exempt interest, see Tax Computation Instructions). \$.....
7. (a) If amount entered on line 6 is not over \$20, enter 33 1/3% of that amount here. \$.....
 (b) If amount entered on line 6 is over \$20 but not over \$70, enter 67% here. \$.....
 (c) If amount entered on line 6 is over \$70 but not over \$80, enter 24% of that amount here. \$.....
 (d) If amount entered on line 6 is over \$80, enter \$201.60 plus 14 1/4% of the excess over \$80 here. \$.....
8. Subtract line 7 from line 6. Enter the difference here. \$.....
9. Enter here one-half of amount on line 5, above. \$.....
10. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount on line 9. Enter the tentative tax here. (If line 3, above, includes partially tax-exempt interest, see Tax Computation Instructions). \$.....
11. (a) If amount entered on line 10 is not over \$20, enter 33 1/3% of that amount here. \$.....
 (b) If amount entered on line 10 is over \$20 but not over \$70, enter 67% here. \$.....
 (c) If amount entered on line 10 is over \$70 but not over \$80, enter 24% of that amount here. \$.....
 (d) If amount entered on line 10 is over \$80, enter \$201.60 plus 14 1/4% of the excess over \$80 here. \$.....
12. Subtract line 11 from line 10. Enter the difference here. \$.....
13. Multiply amount on line 12 by two. Enter the result here. \$.....

Rate and Computation Schedules if Reduction is Integrated With Rate Schedule

RATE SCHEDULE

If the amount on line 5 is:	Enter on line 6 or line 8:
Not over \$1,000	13 percent of the surtax net income.
Over \$1,000 but not over \$1,395.85	\$133.00, plus 20 percent of excess over \$1,000.
Over \$1,395.85 but not over \$2,000	5.2 percent of a surtax net income.
Over \$2,000 but not over \$4,000	\$1.00, plus 16.72 percent of excess over \$2,000.
Over \$4,000 but not over \$6,000	\$638.40, plus 22.23 percent of excess over \$4,000.
Over \$6,000 but not over \$8,000	\$1,083.00, plus 25.6 percent of excess over \$6,000.
Over \$8,000 but not over \$10,000	\$1,506.00, plus 28.07 percent of excess over \$8,000.
Over \$10,000 but not over \$12,000	\$2,177.40, plus 32.46 percent of excess over \$10,000.
Over \$12,000 but not over \$14,000	\$2,827.20, plus 36.76 percent of excess over \$12,000.
Over \$14,000 but not over \$16,000	\$3,562.50, plus 40.18 percent of excess over \$14,000.
Over \$16,000 but not over \$18,000	\$4,366.20, plus 42.76 percent of excess over \$16,000.
Over \$18,000 but not over \$20,000	\$5,221.20, plus 45.31 percent of excess over \$18,000.
Over \$20,000 but not over \$22,000	\$6,127.50, plus 47.88 percent of excess over \$20,000.
Over \$22,000 but not over \$26,000	\$7,085.10, plus 50.44 percent of excess over \$22,000.
Over \$26,000 but not over \$32,000	\$9,102.60, plus 53.01 percent of excess over \$26,000.
Over \$32,000 but not over \$38,000	\$12,283.50, plus 55.57 percent of excess over \$32,000.
Over \$38,000 but not over \$44,000	\$15,618.00, plus 58.05 percent of excess over \$38,000.
Over \$44,000 but not over \$50,000	\$19,167.70, plus 61.66 percent of excess over \$44,000.
Over \$50,000 but not over \$60,000	\$22,881.30, plus 64.12 percent of excess over \$50,000.
Over \$60,000 but not over \$70,000	\$29,263.80, plus 66.69 percent of excess over \$60,000.
Over \$70,000 but not over \$80,000	\$35,932.80, plus 69.25 percent of excess over \$70,000.
Over \$80,000 but not over \$90,000	\$42,858.30, plus 71.82 percent of excess over \$80,000.
Over \$90,000 but not over \$100,000	\$50,061.30, plus 74.38 percent of excess over \$90,000.
Over \$100,000 but not over \$150,000	\$57,448.80, plus 76.95 percent of excess over \$100,000.
Over \$150,000 but not over \$200,000	\$95,526.30, plus 79.05 percent of excess over \$150,000.
Over \$200,000	\$134,001.30, plus 77.60 percent of excess over \$200,000.

COMPUTATION SCHEDULE

5. Subtract line 4 from line 3. Enter the difference here. \$.....
6. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount entered on line 5. Enter the tax here. (If line 3, above, includes partially tax-exempt interest, see Tax Computation Instructions). \$.....
7. Enter here one-half of amount on line 5, above. \$.....
8. Use the tax rates in instruction sheet to figure your combined tentative normal tax and surtax on amount entered on line 7. Enter the tax here. (If line 3, above, includes partially tax-exempt interest, see Tax Computation Instructions). \$.....
9. Multiply amount on line 8 by two. Enter the result here. \$.....

TABLE C

Tax table under present law

Tax table of persons with incomes under \$5,000 not competing tax on page 3

Read down the shaded columns below until you find the line covering the total income you entered in item 6, page 1. Then read across to the column headed by the number corresponding to the number of persons listed in item 1, page 1. Then read down the column headed by the number corresponding to the number of persons listed in item 1, page 1, to find the tax you find there in item 7, page 1.

Table with columns: If total income in item 6, page 1, is--; And the number of persons listed in item 1, page 1, is--; At least; But less than; Your tax is--; At least; than; Your tax is--. The table contains multiple rows of tax values for various income levels and person counts.

Tax Tables Required Under H. R. 4790

Tax Table No. 1.—For single persons or married persons filing separate return with incomes under \$5,000 and not computing tax on page 3

If total income in Item 1, page 1, is—		And the number of exemptions claimed in Item i, page 1,					If total income in Item 1, page 1, is—		And the number of exemptions claimed in Item 1, page 1, is—					
At least	But not more than	1	2	3	4 or more	At least	1	2	3	4	The tax shall be—		more	
											\$	\$		
\$0	\$675	\$0	\$0	\$0	\$0	\$2,325	\$2,320	\$229	\$120	\$40	\$0	\$0	\$0	\$0
675	700	2	0	0	0	2,350	2,375	232	123	43	0	0	0	0
700	725	5	0	0	0	2,375	2,400	235	129	40	0	0	0	0
725	750	8	0	0	0	2,400	2,425	239	129	49	0	0	0	0
750	775	11	0	0	0	2,425	2,450	242	132	52	0	0	0	0
775	800	14	0	0	0	2,450	2,475	246	136	52	0	0	0	0
800	825	17	0	0	0	2,475	2,500	249	141	58	0	0	0	0
825	850	20	0	0	0	2,500	2,525	253	145	61	0	0	0	0
850	875	23	0	0	0	2,525	2,550	256	150	64	0	0	0	0
875	900	2	0	0	0	2,550	2,575	259	154	67	0	0	0	0
900	925	29	0	0	0	2,575	2,600	263	157	70	0	0	0	0
925	950	32	0	0	0	2,600	2,625	267	163	73	0	0	0	0
950	975	35	0	0	0	2,625	2,650	270	168	77	0	0	0	0
975	1,000	38	0	0	0	2,650	2,675	273	172	79	0	0	0	0
1,000	1,025	41	0	0	0	2,675	2,700	276	177	82	2	0	0	0
1,025	1,050	44	0	0	0	2,700	2,725	279	181	85	5	0	0	0
1,050	1,075	47	0	0	0	2,725	2,750	282	185	88	8	0	0	0
1,075	1,100	50	0	0	0	2,750	2,775	287	190	91	11	0	0	0
1,100	1,125	53	0	0	0	2,775	2,800	290	195	94	14	0	0	0
1,125	1,150	56	0	0	0	2,800	2,825	294	199	97	17	0	0	0
1,150	1,175	59	0	0	0	2,825	2,850	297	204	100	20	0	0	0
1,175	1,200	62	0	0	0	2,850	2,875	301	208	103	23	0	0	0
1,200	1,225	65	0	0	0	2,875	2,900	304	213	106	26	0	0	0
1,225	1,250	68	0	0	0	2,900	2,925	308	216	109	29	0	0	0
1,250	1,275	71	0	0	0	2,925	2,950	311	219	112	32	0	0	0
1,275	1,300	74	0	0	0	2,950	2,975	315	223	115	35	0	0	0
1,300	1,325	77	0	0	0	2,975	3,000	319	227	118	38	0	0	0
1,325	1,350	80	0	0	0	3,000	3,025	324	231	121	41	0	0	0
1,350	1,375	83	0	0	0	3,025	3,050	328	235	124	44	0	0	0
1,375	1,400	86	0	0	0	3,050	3,100	332	238	129	49	0	0	0
1,400	1,425	89	0	0	0	3,100	3,150	340	245	136	55	0	0	0
1,425	1,450	92	0	0	0	3,150	3,200	347	252	145	61	0	0	0
1,450	1,475	95	0	0	0	3,200	3,250	355	259	154	67	0	0	0
1,475	1,500	98	0	0	0	3,250	3,300	362	266	163	73	0	0	0
1,500	1,525	101	0	0	0	3,300	3,350	370	274	172	79	0	0	0
1,525	1,550	104	0	0	0	3,350	3,400	377	279	181	85	0	0	0
1,550	1,575	107	0	0	0	3,400	3,450	385	286	190	91	11	0	0
1,575	1,600	110	0	0	0	3,450	3,500	392	293	199	97	17	0	0
1,600	1,625	113	0	0	0	3,500	3,550	400	300	208	103	23	0	0
1,625	1,650	116	0	0	0	3,550	3,600	407	307	215	109	29	0	0
1,650	1,675	119	0	0	0	3,600	3,650	415	314	222	115	35	0	0
1,675	1,700	122	0	0	0	3,650	3,700	422	322	229	121	41	0	0
1,700	1,725	125	0	0	0	3,700	3,750	430	322	236	127	47	0	0
1,725	1,750	128	0	0	0	3,750	3,800	437	337	243	133	53	0	0
1,750	1,775	131	0	0	0	3,800	3,850	445	345	250	141	59	0	0
1,775	1,800	135	0	0	0	3,850	3,900	452	352	257	151	65	0	0
1,800	1,825	139	0	0	0	3,900	3,950	460	360	263	161	71	0	0
1,825	1,850	144	0	0	0	3,950	4,000	467	367	270	169	77	0	0
1,850	1,875	148	0	0	0	4,000	4,050	475	375	277	178	83	0	0
1,875	1,900	153	0	0	0	4,050	4,100	482	382	284	187	89	0	0
1,900	1,925	157	0	0	0	4,100	4,150	490	390	291	196	95	15	0
1,925	1,950	162	0	0	0	4,150	4,200	498	397	298	205	101	21	0
1,950	1,975	167	0	0	0	4,200	4,250	505	405	304	213	107	27	0
1,975	2,000	171	0	0	0	4,250	4,300	513	412	312	220	113	33	0
2,000	2,025	176	0	0	0	4,300	4,350	520	420	319	227	119	39	0
2,025	2,050	180	0	0	0	4,350	4,400	528	427	327	234	125	45	0
2,050	2,075	184	0	0	0	4,400	4,450	535	435	335	241	131	51	0
2,075	2,100	189	0	0	0	4,450	4,500	543	442	342	247	139	57	0
2,100	2,125	193	0	0	0	4,500	4,550	550	450	350	254	148	63	0
2,125	2,150	198	0	0	0	4,550	4,600	558	457	357	261	157	69	0
2,150	2,175	202	0	0	0	4,600	4,650	565	465	365	268	164	75	0
2,175	2,200	207	0	0	0	4,650	4,700	573	472	372	275	175	81	0
2,200	2,225	211	0	0	0	4,700	4,750	580	480	380	282	184	87	0
2,225	2,250	215	0	0	0	4,750	4,800	588	488	388	289	193	93	0
2,250	2,275	219	0	0	0	4,800	4,850	596	495	395	295	202	99	0
2,275	2,300	222	0	0	0	4,850	4,900	604	502	402	302	211	105	0
2,300	2,325	226	0	0	0	4,900	4,950	610	510	410	309	218	111	0
						4,950	5,000	618	518	417	317	225	117	0

TAX TABLE NO. 2.—For husband and wife filing joint return with income under \$5,000 and not computing tax on page 3

If total income in Item 6, page 1, is—		And the number of exemptions claimed in Item 1, page 1, is—		If total income ^{ne} in Item 6, page 1, is—		And the number of exemptions claimed in Item 1, page 1, is—						
At least	But less than	2	3 or more	At least	than	2	3	4	5	6	7	8 or more
		The tax shall be—				The tax shall be—						
\$0 ¹	\$1,350	\$0	\$0	\$0	\$0	\$2.675	\$2,700	\$162.2	\$822	\$2	\$0	\$0
1,350	1,375	3	0	0	0	2,700	2,725	165.5	85	5	0	0
1,375	1,400	6	0	0	0	2,725	2,750	168	88	8	0	0
1,400	1,425	9	0	0	0	2,750	2,775	171	91	11	0	0
1,425	1,450	12	0	0	0	2,775	2,800	174	94	14	0	0
1,450	1,475	15	0	0	0	2,800	2,825	177	97	17	0	0
1,475	1,500	18	0	0	0	2,825	2,850	180	100	20	0	0
1,500	1,525	21	0	0	0	2,850	2,875	183	103	23	0	0
1,525	1,550	24	0	0	0	2,875	2,900	186	106	26	0	0
1,550	1,575	27	0	0	0	2,900	2,925	189	109	29	0	0
1,575	1,600	30	0	0	0	2,925	2,950	192	112	32	0	0
1,600	1,625	33	0	0	0	2,950	2,975	195	115	35	0	0
1,625	1,650	36	0	0	0	2,975	3,000	198	118	38	0	0
1,650	1,675	39	0	0	0	3,000	3,025	202	123	43	0	0
1,675	1,700	42	0	0	0	3,025	3,050	208	129	49	0	0
1,700	1,725	45	0	0	0	3,100	3,150	214	135	55	0	0
1,725	1,750	48	0	0	0	3,150	3,200	220	141	61	0	9
1,750	1,775		0	0	0	3,200	3,250	226	147	67	0	0
1,775	1,800		0	0	0	3,250	3,300	232	153	73	0	0
1,800	1,825	57	0	0	0	3,300	3,350	238	159	79	0	0
1,825	1,850		0	0	0	3,350	3,400	244	165	85	5	0
1,850	1,875	63	0	0	0	3,400		250	171	91	11	0
1,875		66	0	0	0	3,450	3,500	256	177	97	17	0
1,900	1,925	69	0	0	0	3,500	3,550	262	183	103	23	0
1,925	1,950	72	0	0	0	3,550	3,600	270	189	109	29	0
1,950	1,975	75	0	0	0	3,600	3,650	279	195	115	5	0
2,000	2,025	81	0	0	0	3,700	3,750	288	201	121	13	0
2,025	2,050	84	0	0	0	3,750	3,800	306	212	133	19	0
2,050	2,075	87	0	0	0	3,800		315	218	139	25	0
2,075	2,100	90	0	0	0	3,850	3,900	324	224	145	31	0
2,100	2,125	93	0	0	0	3,900	3,950	333	230	151	37	0
2,125	2,150	96	0	0	0	3,950	4,000	342	236	157	43	0
2,150	2,175	99	0	0	0	4,000	4,050	351	242	163	49	0
2,175	2,200	102	0	0	0	4,050	4,100	360	248	169	55	0
2,200	2,225	105	0	0	0	4,100	4,150	369	254	175	61	0
2,225	2,250	108	0	0	0	4,150	4,200	378	260	181	67	0
2,250	2,275	111	0	0	0	4,200	4,250	387	267	187	73	0
2,275	2,300	114	0	0	0	4,250	4,300	396	276	193	79	0
2,300	2,325	117	0	0	0	4,300	4,350	405	285	199	85	0
2,325	2,350	120	0	0	0	4,350	4,400	414	294	204	91	0
2,350	2,375	123	0	0	0	4,400	4,450	423	303	210	97	0
2,375	2,400	126	0	0	0	4,450		430	312	216	103	0
2,400	2,425	129	0	0	0	4,500	4,550	437	321	222	109	0
2,425	2,450	132	0	0	0	4,550	4,600	443	330	228	115	0
2,450	2,475	135	0	0	0	4,600	4,650	450	339	234	121	0
2,475	2,500	138	0	0	0	4,650	4,700	457	348	240	127	0
2,500	2,525	141	0	0	0	4,700	4,750	464	357	246	133	0
2,525	2,550	144	0	0	0	4,750	4,800	471	366	252	139	0
2,550	2,575	147	0	0	0	4,800	4,850	478	375	258	145	0
2,575	2,600	150	0	0	0	4,850	4,900	485	384	264	151	0
2,600	2,625	153	0	0	0	4,900		491	393	270	157	0
2,625	2,650	156	0	0	0	4,950	5,000	498	402	282	163	0
2,650	2,675	159	0	0	0							

EXHIBIT D

PRESENT LAW

HOW TO USE THE PERCENTAGE METHOD OF WITH HOLDING

(This page may be disregarded by any employer using the wage-bracket tables)

The percentage method involves several calculations. In using this method reference must be made to the following table:

Percentage method withholding table

Pay-roll period	Amount of one withholding exemption	Maximum amount subject to 17 percent rate
Weekl.....	\$11.00	44.00
Biweekly.....	22.00	88.00
Semimonthly.....	23.00	92.00
Monthly.....	46.00	184.00
Quarterly.....	139.00	561.00
Semiannual.....	278.00	1,112.00
Annual.....	557.00	2,224.00
Daily or miscellaneous (per day of such period).....	1.11	6.00

The steps in computing the tax to be withheld are summarized below.

1. Multiply the amount of one withholding exemption by the number of exemptions claimed by the employee.
2. Subtract the amount determined in Step No. 1 from the employee's wages. Compare this net amount with the figure shown in the last column of the table above. Take the smaller of these two amounts and multiply it by 0.17.
3. Take the excess, if any, of the net amount found in Step No. 2 over the figure shown in the last column of the table above and multiply by 0.19.
4. Add the tax amounts determined in Steps Nos. 2 and 3. This is the amount of tax required to be withheld.

This series of steps is necessary because Step No. 2 is for the purpose of the first surtax bracket; and Step No. 3, the second surtax bracket. The tax rates in each step give the employee full benefit of the 10-percent standard deduction for charitable contributions, etc., and the reduced surtax rates and 5-percent over-all tax reduction provided by the Revenue Act of 1945.

Example.—An employee has a weekly pay-roll period, for which he is paid \$80, and has in effect a withholding exemption certificate claiming three exemptions. His employer, using the percentage method, computes the tax to be withheld as follows:

Step No. 1:

Amount of one withholding exemption.....	\$11
Multiplied by number of exemptions claimed on Form W-4.....	×3
Total withholding exemptions.....	<u>\$33</u>

Step No. 2:

Total wage payments.....	\$80
Less amount determined in Step No. 1.....	33
(a) Balance.....	\$47
(b) Amount shown in list column of table for weekly pay-roll period.....	\$44
Smaller of (a) or (b) subject to 17 percent rate.....	\$4
	×0.17

Portion of tax to be withheld..... \$7.48

Step No. 3:

Balance shown in Step No. 2 (a).....	\$47
Amount shown in last column of table for weekly pay-roll period.....	44
Balance subject to 10 percent rate.....	
	×0.10

Portion of tax to be withheld..... \$0.57

Step No. 4:

Total tax to be withheld..... \$8.05

Where the withholding is computed for a "miscellaneous" pay-roll period, the wage and the amounts shown in the percentage method withholding table must be placed on a comparable basis. Thus the wage may be placed on a daily basis, by dividing the total wage by the number of days in the period. After computation of the tax on a daily basis using the steps indicated above, the amount so found multiplied by the number of days in the period is the amount to be withheld.

In the case of any employee who has no Withholding Exemption Certificate in effect, or an employee who has claimed no exemption, use no exemptions for purposes of Steps Nos. 1, 2, and 3.

In determining the amount of tax to be deducted and withheld, the last digit of the wage amount may, at the election of the employer, be reduced to zero, or the wage amount may be computed to the nearest dollar. Thus, if the weekly wage is \$37.43, the employer may eliminate the last digit and determine the tax on the basis of a wage payment of \$37.40 or he may determine the tax on the basis of a wage payment of \$37.

H. R. 4700

HOW TO USE THE PERCENTAGE METHOD OF WITHHOLDING

(This page may be disregarded by any employer using the wage-bracket tables)

The percentage method involves several calculations. In using this method reference must be made to the following tables:

Percentage method withholding table

Pay-roll period	Amount of one withholding exemption	Maximum amount subject to 12 percent rate	Maximum amount subject to 18 percent rate
Weekly	\$13.00	\$21.00	\$9.00
Biweekly	26.00	43.00	17.00
Semi-monthly	26.00	46.00	19.00
Monthly	56.00	99.00	36.00
Quarterly	167.00	278.00	100.00
Semiannual	333.00	558.00	219.00
Annual	677.00	1,111.00	440.00
Daily or miscellaneous (per day of such period)	1.80	3.00	1.00

The steps in computing the tax to be withheld are summarized below:

1. Multiply the amount of one withholding exemption by the number of exemptions claimed by the employee.

2. Subtract the amount determined in Step No. 1 from the employee's wages. Compare this net amount with the figures shown in the next to last column of the table above. Take the smaller of these two amounts and multiply it by 0.12.

3. Take the excess, if any, of the net amount found in Step No. 2 over the figure shown in the next to last column of the table above and compare this excess with the figure shown in the last column of the table above. Take the smaller of these two amounts and multiply it by 0.18.

4. Take the excess, if any, of the net amount found in Step No. 3 over the figure shown in the last column of the table above and multiply it by 0.14.

5. Add the tax amounts determined in Steps Nos. 2, 3, and 4. This is the amount of tax required to be withheld.

This series of steps is for the purpose of granting the tax reductions applying to incomes within the first surtax bracket. The exemption amounts and tax rates in each step give the employee full benefit of the 10-percent standard deduction for charitable contributions, etc., and the tax reduction provided by H. R. 4700.

Example.—An employee has a weekly pay-roll period, for which he is paid \$80, and has in effect a withholding exemption certificate claiming three ex.

emptions. His employer, using the percentage method, computes the tax to be withheld as follows:

Step No. 1	
Amount of one withholding exemption.....	\$183
Multiplied by number of exemptions claimed on Form W-4.....	×3
Total withholding exemptions.....	\$30
Step No. 2	
Total wage payments.....	\$80
Less amount determined in Step No. 1.....	30
(a) Balance.....	\$41
(b) Amount shown in next to last column of table for weekly pay-roll period.....	\$21
Smaller of (a) or (b) subject to 12 % rate.....	\$21
	×0.12
Portion of tax to be withheld.....	\$2.52
Step No. 3	
Balance shown in Step No. 2 (a).....	\$41
Amount shown in next to last column of table for weekly pay-roll period.....	21
(a) Balance.....	\$20
(b) Amount shown in last column of table for weekly pay-roll period.....	\$9
	×0.18
Smaller of (a) or (b) subject to 18% rate.....	\$9
Portion of tax to be withheld.....	\$1.62
Step No. 4	
Balance shown in Step No. 3 (a).....	\$20
Amount shown in last column of table for weekly pay-roll period.....	9
Balance subject to 14% rate.....	\$11
	×0.14
Portion of tax to be withheld.....	\$1.54
Step No. 5	
Total tax to be withheld.....	\$5.08

Where the withholding is computed for a "miscellaneous" pay-roll period, the wage and the amounts shown in the percentage method withholding table must be placed on a comparable basis. Thus the wage may be placed on a daily basis by dividing the total wage by the number of days in the period. After computation of the tax on a daily basis using the steps indicated above, the amounts so found multiplied by the number of days in the period is the amount to be withheld.

In the case of any employee who has no Withholding Exemption Certificate in effect, or an employee who has claimed no exemption, use no exemptions for purposes of Steps Nos. 1-5, inclusive.

In determining the amount of tax to be deducted and withheld, the last digit of the wage amount may, at the election of the employer, be reduced to zero, or the wage amount may be computed to the nearest dollar. Thus, if the weekly wage is \$37.43, the employer may eliminate the last digit and determine the tax on the basis of a wage payment of \$37.40 or he may determine the tax on the basis of a wage payment of \$37.

The CHAIRMAN. Mr. Schoeneman, your staff has been in touch with the joint staff?

Mr. SCHOENEMAN. Yes, sir; it has.

The CHAIRMAN. These matters have been matters of discussion between them?

Mr. SCHOENEMAN. They have been.

The CHAIRMAN. And I assume that will continue.

Mr. SCHOENEMAN. I am sure it will.

The CHAIRMAN. Are there any other questions?

If not, thank you very much indeed for your presentation, which, I assure you, will be commended to the earnest consideration of the staff.

Mr. SCHOENEMAN. Thank you very much, Mr. Chairman.

The CHAIRMAN. The next witness is William A. Sutherland, of the taxation section of the American Bar Association.

Will you give your full name, address, and occupation to the reporter.

STATEMENT ON BEHALF OF THE AMERICAN BAR ASSOCIATION BY
WILLIAM A. SUTHERLAND, CHAIRMAN OF THE SECTION OF TAX-
ATION OF THE AMERICAN BAR ASSOCIATION, WASHINGTON, D. C.

Mr. SUTHERLAND. My name is William A. Sutherland, and my address is Washington, D. C.

I am a practicing lawyer and chairman of the tax section of the American Bar Association.

The CHAIRMAN. Proceed, Mr. Sutherland.

Mr. SUTHERLAND. I want to take only a few minutes here. I am speaking in connection with the provisions of the present bill [H. R. 4790] for equalizing income, estate, and gift taxes as between community-property and non-community-property States.

The technical phases of the American Bar Association's plan for equalizing these taxes will be covered by members of the tax section's committee on equalization of taxes in community-property and common-law States, who have given more time to it than I have. However, I am glad of the opportunity of making a brief statement about the work that the American Bar Association has done in connection with the plan because I think that an understanding of the screening process through which these proposals went before they were submitted to the Congress will demonstrate, certainly, much more clearly than any brief analysis of the bill which I might make, the absolute fairness with which the estate- and gift-tax provisions have been worked out, and the substantial equality that they must work as between the citizens of the two types of States.

Incidentally, I think a full understanding of this proposal and the way it was developed by the American Bar Association may do a good deal to persuade this committee to pay considerable attention to the numerous other suggestions we will have to make when the general subject of tax revision comes before the committee.

The problem of equalizing taxes as between the two types of States has long perplexed the lawyers of this country who have recognized the inequality in the present system. The first step by the American Bar Association in developing our present proposal was taken at the

Atlantic City meeting of the association in 1946. At that time the association decided to recommend the split-income proposal with which you are so familiar, and which I need not discuss here.

That proposal came from the American Bar Association.

We realized at that 1946 meeting, before that amendment was finally adopted by the tax section and submitted to the house of delegates—and it was urged upon us by the people from the community-property States—that there was great unfairness which would remain in the estate- and gift-tax fields against the people in the community States, unless the estate and gift taxes were equalized also. Representatives from the community-property States felt, particularly since they were in a minority, that the bar association should not recommend the equalization of the income taxes without at the same time recommending the equalization of the other types of taxes.

We all realized that the problem of estate- and gift-tax equalization was much more complicated and that we could not possibly hope to solve it at that meeting. Therefore, in deference to the wishes of the community-property representatives—and I thought with complete fairness—we did pass a resolution, which was approved by the house of delegates, which provided that the bar association should recommend the repeal of the 1942 amendment pending the working out of a comprehensive plan of equalization.

The tax section then appointed a committee which was given the sole task in the ensuing year of working out a plan for the equalization of estate and gift taxes. That committee was composed of 17 men—11 of them from common-law States and 6 from community-property States. The members of that committee were outstanding lawyers in their communities and nationally outstanding lawyers in the tax field. They set to work first, I may say, with great animosity toward each other and with till attempt by both groups represented to get what the other thought was an unfair advantage. But, as frequently happens when lawyers are brought together and finally made to realize that all the other side wants is fairness and that, in view of their wide experience and background and knowledge of the problems, they are perhaps in a better position than anybody else to work them out, the members of this equalization committee finally, after numerous sessions in which nothing was accomplished, said down and said, "Well, now, wait a minute. We are not getting anywhere. We have got to work this thing out because it is a real problem and we till want to create equality. We should be able to work out a plan to get it."

After this, numerous meetings were held, some of them lasting for several days, at which various examples were brought before the committee by people from both common-law and community-property States. Conferences were held with the staff of the joint committee and with representatives of the Treasury. Finally, at the Cleveland meeting of the bar association in September of last year, the committee presented first to the tax section, and then to the house of delegates of the association, the plan which was finally submitted, and which, in substance is contained in this bill, H. R. 4790.

It seems to me that, when anyone attacks the equality effected by the bill, a great burden rests upon him.

If you look at the names of the people on that committee, and consider that they have sat down together and have thought this thing out and have arrived at what they feel is as substantial equality as can reasonably be worked, I think anyone would realize that, unless we could hit upon some happy solution such as we did with reference to the income tax—and I do not believe that is possible—it is not possible because of the different property situations in different States to have absolute equality in the estate- and gift-tax field.

But we do feel that this bill now works as great equality as Congress should be particularly concerned with at this time, and if later small revisions are necessary, why, that will be only what is true of all the other now provisions that go into the revenue acts.

Senator CONNALLY. May I ask a question there?

The CHAIRMAN. Senator Connally.

Senator CONNALLY. Did these committees consider at any time the repeal, or rather, the retroactive repeal of the 1942 act?

Mr. SUTHERLAND. Senator, you have anticipated exactly what I was going to say next.

I was going to say there are only two features of the un-associated plan—other than minor things which we have thrashed out and are thrashing out with the staff of the joint committee, and with which we do not think it is necessary to trouble this committee here—which are not yet taken care of in H. R. 4790.

The one is retroactive repeal of the 1942 amendment.

I think one reason that retroactive repeal was not included in H. R. 4790 was because some constitutional difficulties were raised which had not been foreseen in the working out of the bill that we prepared.

Senator LUCAS. Do you mean State constitutions?

Mr. SUTHERLAND. No, sir; the United States Constitution.

The retroactive repeal, if it were carried out, would mean that the 1942 amendments would be treated as having had no effect in the past, and this might adversely affect taxes on transactions already past. I am not fully qualified to go into the constitutional question. That problem has been handled by another member of the committee testifying today, and he will be delighted to discuss it in detail, or anything else you wish, in connection with retroactivity.

The CHAIRMAN. I assume there will be someone among the witnesses to do that?

Mr. SUTHERLAND. Mr. Jackson will be able to discuss that fully.

Senator CONNALLY. Just one observation, not a question.

If the act ought to be repealed on the assumption it was unjust from the beginning and people have paid taxes under that unjust provision, would it not be fair for the Government to refund those taxes?

Mr. SUTHERLAND. I think the retroactive repeal is absolutely fair, and I think it can be worked out. But it does involve some complications we had not anticipated, and therefore it is not in H. R. 4790.

But I was going to urge, just as Your Honor spoke, that consideration should be given to retroactive repeal now in this committee, and if complete retroactive repeal cannot be accomplished on account of constitutional limitations, that Congress should at least go as far as it can to see that those amendments are repealed retroactively.

There is one other feature of the bill H. R. 4790 which unduly favors taxpayers in common-law States at the present time, and the reason that this unequal feature exists in the bill as it passed the House is,

I think, because of difficulties in drafting the plan we had recommended. We had recommended that the basis of property passing untaxed from the husband to wife under our plan should be the same basis as the property had in the hands of the decedent. That is, the property would not take a new basis at death, as is true and would remain true within property which is subject to tax.

The bill as it passed the House provides that this untaxed property also will have as its basis the value at death.

I think that this provision creates an unfair advantage in favor of common-law States unless in a community-property State the community property that the wife has at the husband's death, and which she does not get from him, also acquires a new basis.

I hope that this committee will give this problem of equal basis treatment the most careful consideration.

I cannot sit down without taking one moment to discuss the statement which was submitted to this committee on March 1, 1948, on behalf of the Secretary of the Treasury.

I cannot possibly hope to discuss this statement in detail, and I do not think it is useful to do so.

I think the general remarks which I have made about the screening process through which the American Bar Association proposal passed should do more to demonstrate the fairness of our plan and to refute the Secretary's position than any short analysis of the Secretary's remarks could do.

But it does seem rather bad to me that a department of the Government would submit to a committee of Congress a statement that a bill is unfair and should give as its first example the example which you find at the bottom of page 10 of the statement of the Secretary of the Treasury. I think much of the same criticism could be made about most of the other examples cited.

Let me just read the two sentences that are necessary:

An analysis of these sections of the bill reveals they not only fail to bring about equality of treatment, but in fact produce inequalities not present under existing law. Thus, where in a common-law State the estates of husband and wife are substantially equal at the time of the husband's death, leaving his property to the survivor, an estate tax would, by reason of the marital deduction, be payable on only one-quarter of the family wealth; that is, on one-half of the decedent's half.

And the Secretary goes on:

However, in the corresponding situation in which the family wealth consists of community property earned by both spouses, an estate tax would be payable on the death of the first spouse to die with respect to one-half of the family wealth.

Now, in the first place, the Secretary takes an example in a common-law State and then another example in a community-property State, each of which, while not perhaps very rare, is certainly far from the usual situation. Moreover, where the equality of property does exist in a common-law State, it is generally largely by virtue of gifts from husband to wife on which gift taxes have been paid. A fact which the Secretary ignores.

But more important than that, the Secretary goes on to assume that each of these two husbands, when he dies, instead of paying any attention to the over-all tax effect of the disposition of his property, is going to want to do what is probably the most foolish thing he could possibly do, which is to leave the rest of the property outright to his wife. If this is done, the estate of the wife at the time of her

death will consist of a very much larger amount than was present in the husband's estate, so that there will be a very, very high estate tax at the death of the wife. The example chosen by the Secretary also assumes that the husband is going to ignore completely the income tax effect during the remainder of his wife's life of such a foolish disposition.

I do not think the people in the Treasury could be so ignorant of the way property is generally handled as to believe that this sort of an example represents anything other than the most unusual type of case.

I do think in discussing the fairness of a bill with all the implications of this bill, that the usual situation should be first discussed, and that later consideration can be given to all the unusual situations which you wish to discuss, if you have time, and if you think those very unusual situations are of importance.

Thank you.

The CHAIRMAN. Any questions?

If not, thank you very much indeed for coming.

Mr. SUTHERLAND. Thank you, gentlemen.

The CHAIRMAN. Our next witness is Mr. Allan Higgins.

Will you give your name, address, and occupation, please?

STATEMENT OF ALLAN H. W. HIGGINS, CHAIRMAN, AMERICAN BAR ASSOCIATION, SECTION OF TAXATION, COMMITTEE ON EQUALIZATION OF TAXES IN COMMUNITY-PROPERTY AND COMMON-LAW STATES, BOSTON, MASS.

Mr. HIGGINS. I am Allan H. W. Higgins, of Boston, Mass. I am chairman of a subcommittee of the tax section of the American Bar Association, known as the committee on equalization of taxes in community-property and common-law States. This committee consists of 17 members, 6 of whom are from community-property States and 11 of whom are from common-law States.

Senator CONNALLY. You equalized the taxes, but you did not equalize the committee—11 to 6.

Mr. HIGGINS. The ratio of the committee was largely based on the ratio of community-property States to total number of States.

Senator CONNALLY. All right.

Mr. HIGGINS. I am glad to state that the decisions of the committee were unanimous. So there was no overriding of the views of individual members even though they might be in the minority, Senator.

Senator CONNALLY. Fine. Congratulations.

Mr. HIGGINS. I should like to point out to the committee a brief explanation of the provisions of the bill and call your attention to a few changes and omissions with respect to which we would like to make some recommendations.

I might say that my printed statement was prepared and submitted before we had had a conference on Saturday with members of the staff of the joint committee, and a number of the provisions with which we had taken issue and which we thought were not quite in accord with the general purposes of the bill have been gone over with the members of the staff, and also the legislative draftsmen, and substantial accord has been worked out with respect to about all of those changes.

So I will confine my remarks chiefly to those problems that are as yet not solved with respect to the bill as passed by the House.

I think the income tax provisions do not require very much explanation, because they have had such wide publicity in the press.

I do want to point out that the so-called split-income provision does not do violence to the fundamental property laws of the several States. Because of the fact the people in the community-property States had for a long while stressed the importance of separate property ownership of husband and wife, we felt it necessary in working out this equalization bill to hit upon a plan which would not do violence to their fundamental views of property.

That is the reason the so-called split-income provision was put into the joint return section of the law, under which, in the past, it had always been possible for the husband and wife to lump their income and deductions together in a voluntary joint return.

The split-income provision permits exactly the same thing, and there is superimposed upon the existing joint return provision merely a special provision with reference to computing the tax on the aggregate income of the husband and wife as shown in the joint return.

Senator CONNALLY. Let me ask a question right there.

Under the bill and under your plan, the income of the husband and wife regardless of whether community property or separate property, is all lumped into one income and split through the middle; is that right? ... splitting is solely with reference to the

tation you are going to make. It is not as though it was split and apportioned to husband and wife. You take the aggregate income and divide it by 2, computing the tax thereon, and then multiplying said tax by 2. So it is really a computing provision.

Senator CONNALLY. The mechanics of it. But my point is in estimating the income you take the wife's income, if she should have separate income, and add it to the husband's income regardless of whether it is her own or community.

Mr. HIGGINS. That is right.

Senator CONNALLY. So you just have one income.

Mr. HIGGINS. That is right.

Senator CONNALLY. That works both ways, though.

Suppose a man in New York State has an income on his own separate property of a million dollars. His wife has nothing. He gets a pretty substantial advantage from that plan; does he not?

Mr. HIGGINS. That is right, although the advantage is not as great as with the people in the middle brackets. The advantage is not as great with the people in the higher brackets as it is with respect to people in the middle brackets. The man with the high income is already up in a very high tax bracket, and even after splitting the income he is still in a high rate bracket.

Senator CONNALLY. It is not as high after splitting as it is before, is it?

Mr. HIGGINS. When you get into the 80-percent rate—that is, beyond \$80,000 or \$90,000—as in your particular illustration, even after splitting the resulting income is still up in a very high bracket.

Senator BARKLEY. Do you call \$80,000 or \$90,000 a middle bracket?

Mr. **HIGGINS**. What I am referring to is that the largest benefits, I think, would come to people between \$5,000 and \$50,000, and not to people in the brackets above that.

The balance of the income provisions are largely dealing with technical matters such as the medical deduction and other deductions and the figuring of rates, and so on, with reference to the individual returns, and cover some of the matters that were discussed by the Commissioner this morning.

So, I will hasten into the estate and gift taxes, equalization provisions, concerning which there has been very little newspaper publicity, and with respect to which there has been some misunderstanding.

I would like, first, in connection with the estate-tax provisions, to reiterate what Mr. Sutherland said: That our committee and the bar association, at two different conventions, now, have discussed the 1942 amendments so far as they affect the estates of community-property residents, and unanimously recommended the retroactive repeal of the 1942 amendment.

Although we do realize there are some problems in connection with that repeal, we do feel the citizens of the community-property States are entitled to retroactive relief from the hardships and inequities of the 1942 act; and we urge upon the committee they give consideration to granting relief to the citizens of community-property States.

Mr. Jackson is going to cover that subject in considerable detail.

Senator **CONNALLY**. Under the 1942 act, if a man dies, his wife pays an inheritance tax, or estate tax, on the entire estate, regardless of the fact she already owns and possesses one-half of it?

Mr. **HIGGINS**. That is correct.

Senator **CONNALLY**. Of course, that is not fair and not just.

Do you favor the retroactive repeal?

Mr. **HIGGINS**. Yes; we favor retroactive repeal, and there are two suggestions we have made with reference to that, so that the retroactive repeal can be effected without doing any violence to the Constitution.

Senator **CONNALLY**. What is the constitutional point about that?

Mr. **HIGGINS**. If you repeal the 1942 amendment retroactively so that the law then stands as it did prior to the 1942 act, in certain instances there would be a tax assessed on people who since 1942 have not paid a tax with reference to certain estates and gifts.

Senator **CONNALLY**. How is that? You say the effect would be to assess a tax on people who have not heretofore paid any?

Mr. **HIGGINS**. Yes, because the impact and burden of the tax was changed by the 1942 amendment.

If you go back to what the situation was before the 1942 law, you will find that there are certain instances in which there would be a tax where there was not a tax before in connection with certain gifts and estate provisions.

Senator **CONNALLY**. In those few instances, would it not be just as fair to let them suffer as to let the whole mass of community income-tax payers, who pay on estates, suffer the imposition of that sum against them?

Can you not work it out some way that would be just and fair?

Mr. **HIGGINS**. We feel it could be worked out to make it clear that such retroactive imposition of taxes would not occur, and we have suggested such a form of bill to the committee.

Mr. Jackson will cover that in detail in connection with his statement.

Senator BARKLEY: The fact that it would require some to pay taxes who have not paid since 1942 would be a constitutional question, or would it be a question of administration?

Mr. HIGGINS: It would be a constitutional question, Senator. There are a number of Supreme Court decisions to the effect that you cannot retroactively impose a gift or estate tax.

The CHAIRMAN: But we can retroactively give a refund?

Mr. HIGGINS: That is correct.

The CHAIRMAN: And we can retroactively grant an exemption.

Mr. HIGGINS: That is correct.

The CHAIRMAN: So, assuming it should be done, if the thing is kept in a compass of that kind, I can see no possible constitutional question.

Mr. HIGGINS: That is correct.

But just a plain blanket repeal of the 1942 amendment, without putting in the amendments we suggest, might create difficulty.

Senator BARKLEY: You might have to forgive all taxes that might arise under the law retroactively in order to avoid having a constitutional question arise.

You might remit or forgive it, and the Constitution would not prohibit that.

Mr. HIGGINS: Exactly.

The CHAIRMAN: Have you figured how much money that would cost?

Mr. HIGGINS: I am not sure whether any specific estimate has been made if retroactive repeal took place, but I cannot feel it would run into ally great amount of money by the way of refunds when you consider the fact it has been in existence only 5 or 6 years, and there must be some estates where people died in the last year and where returns have not yet been filed. Also we are dealing only with decedents in a small number of community-property States.

I do not know whether the Treasury has made any estimates as to the refunds involved.

Senator CONNALLY: Whatever the amount, it was unjustly collected and ought to be paid back; had it not?

Mr. HIGGINS: That is correct.

The CHAIRMAN: Does it raise the question that in order to achieve equalization you would have to make retroactive the benefits of the split income?

Mr. HIGGINS: I do not think the two provisions are necessarily interrelated.

The CHAIRMAN: Would it pose the question of whether you would have to make retroactive the estate- and gift-tax provisions for the common-law States?

Mr. HIGGINS: I do not think that is involved. As Senator Connally says, if the law was unfair and inequitable, there is no reason why that inequity should be perpetuated even though you do not retroactively permit marital deductions for common-law States.

The CHAIRMAN: You see no repercussion on the common-law States as far as that field is concerned?

Mr. HIGGINS: None whatsoever.

Basically, that is what we have done in order to equalize the situation which would exist after repealing the 1942 amendment. The people in the community-property States would then be in this position; one-half of the property which had been earned in the lifetime of the husband would go over to the wife without any estate tax.

Senator **CONNALLY**. How is that now?

Mr. **HIGGINS**. After the 1942 amendments are repealed, you are then back to the status of the law prior to 1942.

Senator **CONNALLY**. Yes.

Mr. **HIGGINS**. When a husband in a community-property State (lies, half of the community property which the wife owns as the result of the community-property law comes to her at death without the imposition of any estate taxes.

Senator **CONNALLY**. Yes.

Mr. **HIGGINS**. Now, to equalize with the people in the common-law State, we have provided that a spouse in a common-law State may inherit up to one-half of the adjusted gross estate without the imposition of an estate tax, feeling as we do that even though the wife in a community-property State has more definitely a property right in the half of the property—

Senator **CONNALLY**. Not necessarily half in all the property. That is only in the community property.

Mr. **HIGGINS**. Only in the community property.

Senator **CONNALLY**. And your provision would give common-law States the right to take half of it, irrespective of whether made through joint efforts or separate property of the husband, would it not?

Mr. **HIGGINS**. Yes; but you have to have in mind that there in a great many of the common-law States, the wife, by way of a dower, or curtesy, or some statutory share, is entitled at death to a third or a half of the husband's property. So there are some property rights involved in common-law States.

To answer the objection you just made, Senator—

Senator **CONNALLY**. I did not make any objection. I was asking for information.

Mr. **HIGGINS**. This provision in regard to marital reduction would equally well apply to separate property in community-property States, although the marital deduction provided in this bill will not apply to community property because the wife is going to get that half anyway as the result of the community-property laws.

Nevertheless, as to the separate property of the husband and wife in the community-property State, when one of them dies, this marital deduction will apply to their separate property.

So when you aggregate the two things together, the citizens of the two States are substantially equal.

The **CHAIRMAN**. Let me ask you this: The Federal Government, of course, cannot compel a community-property State to grant any refund on taxes which they had collected on the basis of the 1942 amendment; has that problem been thought of?

Mr. **HIGGINS**. You mean the problem with reference to the inheritance taxes?

The **CHAIRMAN**. I am assuming the States have also collected taxes in relation to the 1942 amendment. There would be no way of compelling the States to make refunds if they have collected such taxes, and it would not be desirable to attempt anything of that kind.

Mr. HIGGINS. As a matter of fact, Mr. Chairman, members of our committee have contacted the tax commissioners and attorneys general in the various community-property States and have ascertained that in a great many instances this question has been so controversial that many cases involving the inheritance taxes in the various States have not yet been settled.

The CHAIRMAN. In any event, we would have to leave it to the States, assuming we decided to make it retroactive.

Mr. HIGGINS. In most instances, the various States have indicated they are prepared to grant refunds to the citizens if they have had imposed and laid excess taxes based on the 1942 amendment.

he CHAIRMAN. Have you any idea what the size of that might be?

Mr. HIGGINS. Knowing what a small percentage of the aggregate death duties is represented by inheritance taxes in the several States, as compared to the Federal estate tax, I would think it would be exceedingly small.

The CHAIRMAN. You doubt whether it would be a very heavy burden for any community-property State if it decided to make refunds?

Mr. HIGGINS. I would think not.

I think Mr. Jackson, when he testifies, can give you a little more definite information on that, because he has been checking on that.

I would like to point out that this marital deduction in connection with the estate tax primarily applies to outright transfers to a surviving spouse.

But, in order that there might not be too much violence (none to the ordinary types of transfers, a provision was written into the bill so you could still transfer property in trust for the benefit of your wife, provided that the provisions of that trust were such that the property in the trust would be taxable at the death of the wife.

In other words, the feeling was, with respect to this marital deduction, that it was fair for the Federal Government to give a break to the surviving spouse, but that at the end of that generation of those two taxpayers, when the survivor died, the Federal Government would collect a full estate tax on the second death.

Senator CONNALLY. At such new rate as the Congress might adopt?

Mr. HIGGINS. That is right.

Senator CONNALLY. The rate as of the date of her death rather than the rate back when the transfer was made?

Mr. HIGGINS. Exactly.

Senator CONNALLY. All right.

Mr. HIGGINS. We worked out numerous situations in the committee and found that this estate-tax provision did do substantially justice; and we take very strong issue with the statement of the Secretary of the Treasury that these estate-tax provisions do not work out to substantial justice.

We also take issue with that part of his statement in which he indicates the 1942 amendments did do substantial justice, for, as Mr. Jackson will point out to you, there were numerous instances where the 1942 amendments were inequitable and did not work out with equalization.

There were some criticisms in our written statements with reference to limitations on trusts that could be set up in order to avail marital deductions. However, after a conference on Saturday with members of the staff, most of those criticisms were ironed out, and I believe that

there are practically no instances now where the type of trust that people would normally desire to set up for their wives, cannot be set up, and the marital exemptions or deductions obtained.

So I will skip over those limitation provisions which were thoroughly discussed in my statement and most of which are not applicable now, in view of the changes that the staff have indicated they would put in.

The **CHAIRMAN**. Where does that take you in your statement?

Mr. **HIGGINS**. It takes us through page 9.

Section 61 of the bill makes adjustment with reference to the property previously taxed, because of the fact that the property will now have the benefit of the marital deduction.

The House bill, as was pointed out by Secretary Snyder did fail to include a provision for credit for gift taxes previously paid.

* It is our understanding, however, in talking with the staff and the legislative draftsmen that such a provision for credit for gift taxes paid is in the course of being drafted and will be included in the bill as submitted to the Senate.

To further the equalization a provision was put in for a marital deduction in connection with gifts to spouses. That was handled by providing that in a common-law State, where one spouse made a gift to another, then 50 percent of the gift to the spouse would be exempt from gift tax. The remaining half would, of course, be subject to gift tax.

If you integrate the gift- and the estate-tax provisions of the bill, they work out to substantial justice.

Of course, the husband in a community-property State is able to get one-half of his earned income and the property, which has built up from those earnings, over to his wife under the community-property law, and without the imposition of either a gift or estate tax.

Accordingly, some analogous benefit had to be provided for the people in the common-law State.

I would like to point out, though, there is quite a distinction between the marital deduction in the gift tax, and the marital deduction in the estate tax. Under the estate tax, the entire transfer to the wife is exempt from tax, there being only a limitation that it cannot exceed more than 50 percent of the estate; whereas under the gift tax, each individual gift that is made to the spouse, one-half of it is exempt from tax.

So that the two types of marital deductions are quite different.

There was another phase of the gift tax which I think, is important to cover, and that is the question of gift to a third party.

A husband and wife in a community-property State may transfer from the community property to a third person, we will say, a son or a daughter, and since that gift is a gift of community property, it is deemed to have been made one-half by the father and one-half by the mother.

So they get the benefit of two separate exclusions, and they get the chance to use up the two separate specific exemptions.

In order to equalize with common-law States, there is a provision in the bill that on gifts to third parties, the spouses can elect to treat those gifts as made one-half by each, even though the whole of the gift may have been made by one of the spouses; and there is a provision for them to make such an election in connection with filing the returns.

Senator **LUCAS**. That provision is in the bill at the present time?

Mr. HIGGINS. That is correct.

Senator **LUCAS**. And that equalizes the situation that you detailed?

Mr. HIGGINS. That is correct. Senator. We had some criticisms in our printed statement with reference to the method of making that election, but I understand from conferences with the staff that those objections are going to be taken care of in the bill.

Senator **LUCAS**. Let me ask you this, **Mr. Higgins**: Is there any real controversy now existing between the common-law and the community-property States, if we adopt the measure that you suggest?

Mr. HIGGINS. I would say the only open questions are the two that **Mr. Sutherland** enumerated. The first one is retroactive repeal, which has been omitted from the House bill; and the second thing is this question of adjustment of the cost basis, which is the next subject that I was going to take up.

In order to equalize with the community-property States, we had a provision in the American Bar Association bill that the property which received marital deduction would not acquire the basis of value at (late of death. A taxpayer would be put in the same position with respect to property which had the benefit of the marital deduction as the community-property people had been in with reference to the share the wife got out of the community property.

Senator **LUCAS**. There can be no question but what there have been inequities existing, as far as these taxes are concerned, as between the common-law States and the other States.

Mr. HIGGINS. That is correct.

Senator **LUCAS**. And this is the first attempt to place the 48 States in the Union on an equal basis from the standpoint of income, estate, and gift taxes.

Mr. HIGGINS. That is correct.

When the legislative draftsmen set out to make the changes we suggested in the 113 (a) (5), they found they ran into problems where a wife got a percentage of an estate, as to just how you were going to make these adjustments on a cost basis. It is a much more difficult problem than members of my committee had anticipated. And, as time was short, the changes in the 113 (a) (5) were left out of the House bill, and consideration has been given to that subject since.

It is our opinion, after struggling ourselves to try to draft an amendment to 113 (a) (5) that perhaps the fairest thing to do, to bring the citizens of the common-law and community-property States to an equal basis, would be to provide that the property which the surviving spouse got in the community-property State at death should take as its basis the value at date of death.

The **CHAIRMAN**. Should or should not?

Mr. HIGGINS. Should. That would be a simple provision to put into the law. It would merely mean adding a few more words to section 113 (a) (5), and frankly, after reanalyzing the situation it is the opinion of our committee that that probably should have been done for the benefit of the people in the community-property States long ago, because they have had some very difficult problems.

You take a ranch property or an oil property, if the first spouse dies, one-half of that property for the purposes of not only future sale but also depletion and depreciation, has the cost of the community and

the other half has the value at date of death. The latter is the half that came over from the husband, his share of the community if he gave it all to his wife. This means that in a depreciation schedule in a community-property State they have to play with two cost bases with respect to the same property. The thing became even more unfair under the 1942 amendments when the estate tax was collected on the market value of the entire property at death, and yet for the purposes of selling part of the property in order to pay the estate tax, the cost basis of half of it was the cost to the community.

The CHAIRMAN. What is your suggestion?

Mr. HIGGINS. My suggestion is that 113 (a) (5) be amended to provide that not only property which was acquired by inheritance, bequest, and devise, shall have the value at date of death, but also property which is acquired by a surviving spouse by operation of the community-property law.

The CHAIRMAN. That might work a very substantial increase in cost base so far as the speculative property is concerned; might it not?

Mr. HIGGINS. Yes. But that is equally true in the common-law States. When a decedent in a common-law State dies, if there has been a very great appreciation in the value of the property, the survivors acquire as the cost basis of the property which they have inherited, the value at date of death.

The CHAIRMAN. Might that not be considered then as an added burden, rather than as an equalization, so far as the community-property States are concerned?

Mr. HIGGINS. Certainly in a period of a rising market, it would not be a burden. It would be a boon.

Senator LUCAS. Do those in the community-property States favor that?

Mr. HIGGINS. Yes.

Senator LUCAS. What you are doing again here is eliminating an inequity and placing all States again more or less on the same basis.

Mr. HIGGINS. I see no reason why the surviving spouse in a common-law State should acquire any different basis for the property which actually came over, we will say, from the husband, than the surviving wife in a community-property State.

Senator LUCAS. I agree with you.

Mr. HIGGINS. They ought to be on exactly the same basis, in all justice and fairness.

The CHAIRMAN. There is one distinction: That in the community-property State the wife, at least theoretically, owned her half with the original cost assigned to it; it is only by virtue of this law that any different situation occurs.

Mr. HIGGINS. There is something very definite, however, that occurs on death, Senator, and that is the wife, at death, even in the community-property State, acquires a right of severance of her property at that time that she did not have prior to the death. So that something very definite does take place at death to throw the full interest in the property, without her husband's control, over into her hands. Something very definite has occurred with respect to that property, at death.

It is very similar to the wife's right of dower or statutory interest in a common-law State. That right of dower arises at the time of death.

CHAIRMAN. That points the distinction. The dower right is in a sense inchoate, until death occurs, whereas in the community-property State the actual right of the ownership occurs from the inception of the community.

Mr. HIGGINS. But the wife, until death, does not have control of the property. The husband has control of the ownership.

Mr. HIGGINS. That is right.

Senator BARKLEY. It is a joint ownership. Her particular half is not identified, necessarily.

Mr. HIGGINS. That is right.

Senator BARKLEY. It is joint ownership of the two. If she wants her half it cannot be divided so that she can say this is mine and that is yours.

Mr. HIGGINS. So that you agree that something definite, in addition, does occur at death to provide for a division of it.

Senator BARKLEY. Yes. It is undivided and in joint ownership; and, when the husband dies, she can say, I want my half all to myself, the other half can go to the estate or to the children or whoever it can go to. It can be divided then. She can identify what otherwise before that she could not identify, except as a mere joint ownership in property.

Mr. HIGGINS. That being so, we feel that the simplest answer to this basic problem is to give all the citizens the right to take the market value at date of death as the basis of any property that has come over to the surviving spouse.

The **CHAIRMAN** Might that cost basis exceed the marital deduction?

Mr. HIGGINS. I do not quite get your question, Senator. You mean in cost to the revenue?

The **CHAIRMAN.** Your cost, might not that exceed your marital deduction?

Mr. HIGGINS. That all depends, of course, on the value of the property. But for the purposes of the estate tax, the value is taken at date of death.

The **CHAIRMAN.** It is conceivable that that might happen, I believe.

Mr. HIGGINS. It certainly seems most unfair where property may have to be sold in order to pay the estate tax, that you have to go back and take a cost which may have been incurred years ago and which might possibly be a very low cost, and then pay a capital-gains tax in order to raise money to pay the estate tax, when people in common-law States do not have to do that.

Senator BARKLEY. The question, of whether it might exceed the marital deduction would depend on whether the value of the property had increased since its original acquisition.

Mr. HIGGINS. That is correct.

Senator BARKLEY. It is possible, of course, that half of an estate at death of either spouse might be more valuable than all of it at the time it was acquired.

Mr. HIGGINS. Surely.

Senator BARKLEY. Also it might not be worth more than half. So that it works both ways.

Mr. HIGGINS. That is what the whole purpose of our committee has been, to work out a just and equitable solution for the citizens of both types of States. And if it is necessary to make this change in the cost basis in order to do it, we feel that like committee ought to go whole hog and iron out all of these difficulties at this time.

Senator BARKLEY. It seems perfectly obvious to me, as suggested by Mr. Sutherland, that we are doing a rather radical and revolutionary thing here and it is going to take a little experience to reveal the bugs, but as suggested by him, we can iron those out when we come to them.

The CHAIRMAN. I doubt very much whether we can here, now, set up a complete change in these systems that will work without further amendment. We will be bound to need of amendments in the future.

Mr. HIGGINS. It is our feeling if this works out 90 or 91 percent equalization and makes a 90 or 95 percent correction of a problem which has been a thorn in the sides of all of us and in the side of the Treasury Department for years, that this will be a great step forward.

We have received extraordinary cooperation from members of the staff and the legislative draftsman and people we have conferred with, and the Treasury Department, and I do hope that the Senate and this committee will face this question in the same nonpartisan and bipartisan spirit as have the members of the American Bar Association, who have tried to work out this problem.

Thank you very much.

The CHAIRMAN. You are welcome. We are glad to have had you here.

Mr. HIGGINS. Thank you.

(The prepared statement submitted by Mr. Higgins is as follows:)

STATEMENT ON BEHALF OF THE AMERICAN BAR ASSOCIATION BY ALAN H. W. HIGGINS, CHAIRMAN OF AMERICAN BAR ASSOCIATION, SECTION OF TAXATION, COMMITTEE ON EQUALIZATION OF TAXES IN COMMUNITY-PROPERTY AND COMMON-LAW STATES, RE SECTIONS OF H. R. 4700 DEALING WITH EQUALIZATION OF FEDERAL INCOME, ESTATE, AND GIFT TAXES BETWEEN COMMUNITY-PROPERTY AND COMMON-LAW STATES

INTRODUCTION

I am Alan H. W. Higgins, of Boston, Mass. I am chairman of a subcommittee of the tax section of the American Bar Association known as the committee on equalization of taxes in community-property and common-law States. This committee consists of 17 members, 6 of whom are from community-property States and 11 of whom are from common-law States.

After a thorough study of the problem, consultation with numerous attorneys and representatives from both common-law and community-property States, and with representatives of the Treasury Department and the technical staff of the Joint Committee on Internal Revenue Taxation, my committee unanimously recommended a proposed bill to equalize Federal income, estate, and gift taxes. The tax section of the American Bar Association unanimously submitted the bill to the house of delegates of the American Bar Association and the house of delegates on September 20, 1947, unanimously approved a resolution recommending the enactment of the bill or its equivalent in purpose and effect. My committee, thereupon submitted the proposed bill to the Ways and Means Committee and the staff of the Joint and Congressional Committee of Internal Revenue Taxation. Thereafter, a substantial number of the recommendations of our committee were included in H. R. 4700, as passed by the House of Representatives on February 3, 1948.

It is my purpose to explain the general provisions of the bill so far as they relate to equalization of taxes between the common-law and community-property States and also to urge upon you certain changes in H. R. 4700, which we think are necessary in order to carry out a fair equalization between the citizens of the various States.

The equalization provisions appear in title III of H. R. 4700—part I dealing with income tax; part II with estate tax; and part III with the gift tax, appearing on pages 12 through 32 of the bill.

PART I. INCOME TAX

Sections 301 through 305 propose to amend the Internal Revenue Code so that husbands and wives, who voluntarily file joint returns, will in substance compute their joint tax by dividing the combined income of the spouses in half, computing the tax thereon, and then multiplying said tax by 2. This is the so-called split-income plan and results in putting taxpayers in common-law States on substantially an equal basis with taxpayers in the community-property States with respect to Federal income taxes. Such provision does not do violence to the fundamental property laws of any of the individual States. The return, as filed, is a joint return which shows thereon the combined income of the husband and wife and their aggregate deductions. It does not apportion to the wife one-half of the husband's income. It merely provides for a method of computing the aggregate taxes of the husband and wife when they elect to file a joint return.

The balance of the sections under part I deal with technical amendments, such as the deduction for medical expenses in the joint return. The amendments with reference to the income-tax provisions are by section 305 made applicable with respect to taxable years beginning after December 31, 1947.

PART II. ESTATE TAX

Subpart 1. Repeal of 1942 community-property amendments

Sections 351, 352, and 353 provide for the repeal of the so-called 1942 community-property amendments to the estate tax. The bar association had recommended that such repeal be retroactive so as to be effective as of the date of the enactment of the Revenue Act of 1942. The House provisions in 4700 provide for such repeal but make it effective as of the date of the enactment of the Revenue Act of 1948.

My committee still feels that the citizens of the community-property States are entitled to retroactive relief from the hardships and inequities of the so-called 1942 community-property amendments. This subject will be covered by a member of my committee, Mr. Paul Jackson, of Dallas, Tex., who will make a statement on behalf of the representatives of the community-property States.

Subpart 2. Marital deduction for bequests, etc., to spouse

Subpart 2 commencing with section 301 of the bill provides in connection with the estate tax a special marital deduction for bequests, devises, and transfers to a surviving spouse. This marital deduction is designed to equalize, so far as possible, the estate taxes as between the common-law and community-property taxpayers. Subject to certain limitations, there is deducted from the estate of the first spouse to die the value of any interest passing to the surviving spouse, but such deduction is limited so as not to exceed 50 percent of the adjusted gross estate.

The exemption, however, will not apply to decedent's interest in community property as, after the repeal of the 1942 community-property amendments, the surviving spouse in a community-property State will receive half of the community property exempt from estate tax. Although the marital deduction does not apply to community property, it will apply to the separate property held by the decedent in a community-property State. Thus, if such a decedent had at death \$300,000, consisting of \$100,000 of separate property and \$200,000 of community property, his estate subject to estate tax would consist of \$200,000—i. e., \$100,000 of separate property and \$100,000 representing the decedent's one-half interest in the community property. While he could not devise to his wife tax-free any part of his interest in the community property, he could devise his separate property to his wife and secure thereon a 50-percent exclusion. In such a case, if he left his entire \$200,000 estate to his wife—i. e., \$100,000 of separate property and his \$100,000 interest in the community property—he would be taxed on \$150,000. This would represent his \$100,000 interest in the community property passing to the wife without the 50-percent exclusion, plus the \$100,000 of separate property passing to his wife, subject to the 50-percent exclusion.

On the other hand, if a husband in a common-law State died with a \$300,000 net estate he could by will also pass \$150,000 to his wife free of tax, leaving only

\$150,000 to be subjected to the Federal estate tax. Thus, in both cases the tax is the same, whether the property is held on a common-law or a community-property State.

The marital deduction applies in general only to absolute transfers to the surviving spouse in fee simple, except that tile transfer to the surviving spouse may be in trust, provided that the trust meets certain conditions.

The limitations in the House bill with respect to transfer in trust for a surviving spouse are much more stringent than those recommended by the American Bar Association; and we submit that they are more stringent than is necessary to protect tile revenue. The provisions in the bill proposed by the bar association in substance granted a marital exclusion in all cases where the property transferred by the spouse first to die would be taxable in the surviving spouse's estate, if he or she died directly thereafter.

The new subsection 812 (e) (1) (E), appearing on page 21 of the bill provides that to secure the marital deduction in the case of a transfer in trust for tile surviving spouse, the following conditions must be satisfied:

- (1) The trust must terminate upon the death of the surviving spouse;
- (2) The surviving spouse must be entitled to all the income for her life payable annually;
- (3) The surviving spouse must have a power to appoint by will the entire corpus to her estate; and
- (4) The surviving spouse must have no power in herself or tiny other person to appoint or invade any part of the corpus during her life.

Under the House bill, each of these four conditions must be complied with for tile decedent to obtain the marital deduction on property passing in trust for the surviving spouse.

Our committee, in drafting tile proposed bill followed the principle that, if such a marital deduction is allowed to the estate of the spouse first to die, then whatever part of the interest passing to the surviving spouse remains at the time of his or her death should be subject to the estate tax at that time. This ties in with the situation which existed in the community-property States before the 1942 amendments. Under the community-property law, a surviving wife secured her interest by operation of law; and, prior to the 1942 amendments, such interest was not subject to estate tax. The marital deduction provided for in the bill acts to put the surviving wife in a common-law State on substantially the same basis estate-tax wise. When the surviving wife in the community-property State dies, whatever she has in her estate is subject to the estate tax. Accordingly, the wife in a common-law State who receives property from her decedent husband free from estate tax should be on substantially the same basis.

It has long been the custom to protect wives by placing property in trust. As long as the trust property is taxed at the death of the surviving spouse, the marital deduction should apply irrespective of the varying provisions of the trust. Certainly any limitations as to the application of the marital deduction to trusts should not be so stringently drawn that customary types of trusts will not be permitted to receive the deduction. As long as the corpus will be taxed at the death of the surviving spouse, unnecessary conditions should not limit the bill.

Condition (1) referred to above requires that the trust must terminate on the death of the surviving spouse. This limitation is unnecessary in order to make the corpus of the trust taxable in the wife's estate. It appears that if the surviving spouse has a general power of appointment, the trust corpus would be included in her gross estate for Federal estate-tax purposes. If there are minor children living at the death of the surviving spouse, it may be desirable to have the trust continue for such minor children. Tile wife could be given a general power of appointment, and if the exercise or nonexercise of a general power of appointment in the surviving spouse makes the corpus of the trust taxable in her estate, tile revenue would be protected.

Limitation (2) also appears unnecessarily stringent in requiring that such spouse be entitled for her life to all the income from the corpus of the trust, payable annually or at more frequent intervals. It is very usual in trusts to give the trustees discretion to pay such part of the income to the beneficiary as the trustees deem advisable. This permits the trustees to even out income between good and bad years, to accumulate for emergencies, and to act generally for the best interest of the beneficiary. It would seem to be sufficient if such limitation provided only that the surviving spouse be the sole income beneficiary of the trust. If the accumulated income is going to be includible with the corpus in the estate of tile surviving spouse, the estate-tax revenues are insured.

Limitation (3) which provides that the surviving spouse must have the power to appoint by will the entire corpus to her estate is also unnecessarily limited. It is submitted that it should be sufficient if the surviving spouse has a general power to appointment by deed or will. If she appoints by deed, the Government will collect a gift tax. Moreover, it is submitted that there is no reason why the power should be limited to appoint the corpus of the trust solely to her estate. For reasons above stated, it may well be desired to appoint in trust for children. As long as the surviving spouse's disposition of the property is such as to make it taxable in his or her estate, the deduction should apply.

Similarly, limitation (4) is too restrictive. This provides that there shall be no power in the surviving spouse or any other person to appoint or invade any part of the corpus during her life. Since the marital deduction is to be granted where the gift is outright to the surviving spouse and such surviving spouse could dispose of all or part of the property during his or her life (subject, of course, to gift tax on any gifts), no useful purpose is served by limiting the power to invade the corpus of a trust.

Many trusts contain provisions for the protection of the wife to permit the trustees to pay her part of the principal for emergencies, such as sickness, etc. If the wife had the property outright, she could spend principal for her support; and yet the marital deduction would apply. Accordingly, such power should not be condemned in the use of a trust for a surviving spouse. Such power of invasion in fact makes the transfer in trust all the more like an outright gift. Accordingly, under a trust, a surviving spouse should be permitted to receive any part of the corpus without limitation.

It is submitted, accordingly, that the limitations in the proposed section 812 (e) (1) (B) should be substantially changed to carry out the general intent of the equalization bill.

Section 812 (e) (1) (D) provides for a special kind of limitation, namely, that the interest of the surviving spouse is to be reduced by any estate, succession, legacy, or inheritance tax applicable to such interest. It is submitted that this is an unnecessary limitation and that the computations required thereunder may well be difficult for the average executor who is preparing the Federal estate-tax return. Such a difficult computation is already made part of the law in connection with charitable deductions and has caused considerable difficulty. It is believed that the amount of revenue which would be lost by the failure to impose such a limitation would be negligible. Certainly, the benefits of the bill intended to be provided for surviving spouses should not be limited or reduced in this matter.

Section 812 (e) (2) (B) involves special rules in cases involving community property and this section will be discussed in detail by Mr. Jackson in connection with his presentation in behalf of the representatives of the community-property States.

Section 802 deals with property previously taxed. This provides that the deduction for property previously taxed will be limited by excluding therefrom property previously subject to the marital deduction and received from the spouse first to die.

Proviso for credit for gift taxes paid

The bill fails to include a proviso for credit for gift taxes previously paid but it is our understanding from conferences with the legislative draftsmen that such a provision is under consideration in connection with proposed Senate amendments to the bill.

PART III. GIFT TAX

Part III of the bill seeks so far as possible to put the residents of community-property and common-law States on an equal basis so far as gift taxes are concerned. It also provides for the repeal of the 1942 amendments with respect to gifts in community-property States. Such repeal is made effective as of the date of the enactment of the Revenue Act of 1948. The bar association recommended that such repeal be effective retroactively to the date of enactment of the Revenue Act of 1942. Our committee submits that the residents of community-property States are entitled to retroactive relief from the inequitable provisions of the 1942 act. Mr. Jackson will also cover this subject in his statement.

BETWEEN SPOUSES

The balance of the sections under part III deals with two problems: First gifts between spouses, and, secondly, gifts to third parties.

Without section 372, gifts between spouses would, after the repeal of the 1942 community-property amendments, be subject to unequal tax results in the community-property and common-law States. If community property is given to the wife, the whole becomes her separate property, yet the gift tax is only on the husband's half interest, since, under the community-property law, the wife is already the owner of the oilier half. On the other hand, if a husband in a common-law State gives property which he has accumulated during the marriage to his wife, the whole value of the property is subject to gift tax. Accordingly, to equalize the gift tax, section 372 provides that in gifts between spouses (other than of the donor's interest in community property) only one-half of the value of the gift shall be taxed. This section, when correlated with the estate-tax provisions, achieves substantial equity.

The operation of section 372 is illustrated by the following example: If a husband gives his half interest in community property, which has a total value of \$100,000 and the gift tax is applied only on this amount. The 50-percent exclusion provided for in section 372 will not apply to the donor's half in the community property. On the other hand, if a husband in the common-law States gives his wife \$100,000, the 50-percent exclusion will apply and the tax will be computed only on an equivalent \$50,000.

Gifts to third parties

Gifts to third parties present an additional problem. A gift of community property, after the repeal of the 1942 amendments, when made to a third party is deemed to be made half by the wife and half by the husband. Each has a separate exemption and can compute the gift tax separately. The gift tax on such gifts in community-property States is accordingly lower than if the whole gift were chargeable to the donor husband in the common-law State. To equalize the gift taxes on such gifts, section 374 provides that where a gift is made by either spouse, the spouses may in filing gift-tax returns treat such gifts as having been made one-half by each spouse. Thus, if a father gives \$100,000 to a son, the father and mother can, for gift-tax purposes, compute the tax as though each had made a gift of \$50,000.

As in the case of the marital deduction under the estate tax, a provision was inserted in the bill (the proposed new section 1004 (a) (3) (D)) so that transfers in trust could have the benefit of the marital deduction for gift-tax purposes, provided the trust met certain conditions. The House bill contained the same limitations with respect to such transfers in trust for gift-tax purposes, as were contained in the estate-tax provisions. Our comments and our recommendations, with respect to these conditions, are substantially the same under both provisions; and, if corrections and changes are made under the estate tax, similar corrections and changes should be made under the gift tax.

The election or consent of the spouses to split gifts to third parties is to be governed by certain provisions of 374 (f) (1) (B) and (2). Our committee submits that these provisions with respect to the manner of exercising the election are far more limited than is necessary or desirable. Subparagraph (2) first provides that the consent under the subsection (1) be signified at such time and in such manner as is provided under regulations prescribed by the Commissioner with the approval of the Secretary. Secondly, the section provides that title right to consent shall not exist unless the return was filed on time.

We submit that the time and manner of making such an important election should not be left to the discretion of the Commissioner.

Even more serious is the deprivation of the taxpayer's rights by his mere failure to file his gift-tax return on time.

Of all the types of returns, which are required to be filed with the Treasury Department, there is less knowledge on the part of taxpayers about gift-tax returns and more tendency to file returns late. Many taxpayers either do not know about the gift tax or have misconceptions as to the amount of the exclusions or the specific exemptions. Lawyers throughout the country can cite instance after instance of taxpayers who have unintentionally failed to file gift-tax re-

turns and have not had the matter brought to their attention until they have consulted an attorney about drawing a will or some other matter. To deprive such taxpayers of the benefit of section 374, merely because the return was not filed on time, would be a gross injustice. We know of no instance where such an exceedingly restrictive and unjust provision has been inserted in the revenue laws. No such provision exists in connection with the right of taxpayers to file a joint return or to claim the benefit of deductions, losses, credits, etc.

It is perfectly all right, as in the case of joint returns, to provide that after an election has been made that such election cannot be changed or revoked, but it would be most unusual to provide that, where no action had been taken whatsoever, that the right to file such a consent had been lost.

This is all the more true in a situation such as with gift taxes which most taxpayers do not have to file annually and about which there is very little general knowledge among our citizens.

It is submitted that it would be sufficient to state under section 1000 (f) (2) that a consent under this subsection shall be signified at the time that each of said spouses files his or her gift-tax return and in such manner as provided under regulations provided by the Commissioner with the approval of the Secretary.

Adjustment of cost basis

In connection with equalizing the income, estate, and gift taxes between the common-law and community-property States, it is necessary to place the citizens of the respective States on a similar footing with respect to the basis for property acquired from the spouse first to die. This would involve an amendment of section 113 (a) (5) of the IRC. Where a surviving spouse in a community-property State acquires property from a decedent spouse by operation of the community-property law, it has been ruled that such spouse did not acquire the property by devise, bequest, or inheritance under section 113 (a) (5) and accordingly is not entitled to take the value as of the date of death for the purpose of determining gain or loss on future sale. If the property were a farm or an oil well, and the surviving spouse acquired a one-half interest therein by operation of the community-property law and the other one-half interest therein by specific devise under the will of the spouse first to die, the property then has two cost bases. One-half of it takes, as its cost basis, one-half the cost or purchase price to the community and the other one-half takes as its cost basis one-half of the value at date of death.

The bar association originally proposed that where the marital deduction was claimed for the purposes of estate and gift taxes, then the interest of the surviving spouse which wits not subject to tax in the estate of the spouse first to die should have, as its cost, the cost to the decedent.

In connection with the drafting of the bill by the draftsmen of the House, it appeared that such a provision would get exceedingly complicated and might become unworkable. Accordingly, it was left out of the House draft of the bill.

It is submitted that the inequity could be corrected in another way by simply providing in section 113 (a) (5) that value at date of death could be claimed as the cost basis not only of property acquired by bequest, devise, or inheritance but also of property acquired by operation of the community-property law upon the death of a spouse first to die.

Such a provision would limit surviving spouses in both the community-property and common-law States on exactly the same cost basis and would eliminate a long-outstanding inequity.

CONCLUSION

The members of my committee from both the community-property and common-law States have shown a remarkable spirit of cooperation in attempting to bring about equalization. A similar spirit of cooperation has been shown by the Members of Congress and of the congressional committees, the representatives of the staff of the Joint Committee on Internal Revenue Taxation, and the legislative draftsmen.

The equalization provisions of H. R. 4790 represent substantial progress toward the goal of equality; and we believe that with certain changes and corrections

which we have suggested, the equalization provisions should have the complete bipartisan or nonpartisan support of your committee and the Congress.

Respectfully submitted.

ALLAN H. V. HIGGINS,

Chairman, Committee on Equalization of Taxes in Community Property and Common-Law States.

MARCH 8, 1948.

The CHAIRMAN. Mr. J. Paul Jackson is the next witness.

Mr. Jackson, will you be seated and give the reporter your name, address, and occupation?

STATEMENT OF J. P. JACKSON, ATTORNEY, DALLAS, TEX.

Mr. JACKSON. My name is J. P. Jackson. I am an attorney front Dallas, Tex.

I am a member of this special committee of the American Bar Association and also spokesman for the State Rights Association of Houston, Tex.

The CHAIRMAN. Mr. Jackson, what is the State Rights Association? Is that an association of lawyers?

Mr. JACKSON. No. It is a State association of taxpayers formed particularly for the purpose of considering equalization of taxes between the common-law and community-property States and particularly to seek the repeal of the 1942 amendments.

In this capacity we advocate the adoption of the estate and gift tax provisions of H. R. 4790.

Senator LUCAS. What was the theory of that 1942 amendment, if I may inquire? How did it happen to get through this august body?

Mr. JACKSON. It got through as a part of the War Revenue Act of 1942. It was passed in the last stages in the House without the benefit of committee hearings. Members of the community-property States were never accorded an opportunity to be heard. That bill was passed in the closing days of the session in 1942 and has been with us since that time.

This 1942 act, Senator—I will depart from my statement to give it to you briefly—the 1942 act adopted for the then eight community property States a new concept of taxation. Traditionally, as we all know, Federal estate taxation is based upon the concept of taxing the transmission of property at death. If property owned and transmitted at death was subject to the estate tax.

Now, the 1942 amendments for the community property States, and for those States alone, adopted a new concept. This concept was the concept of economic attribution. A man was intended to be taxed in the community property States and in the community property States alone, if, theoretically, he was the originator of wealth. If he was responsible, years ago, for the creation of that wealth then the theory of this bill was that he should be taxed on that wealth without regard to the question of whether he owned it and whether he could transmit it at death.

¹ Committee: Allan H. W. Higgins, chairman, Boston, Mass.; William C. Allee, Detroit, Mich.; David B. Buergler, Pittsburgh, Pa.; George B. Cleary, New York, N. Y.; Frank M. Coburn, Toledo, Ohio; Charles B. Dunbar, New Orleans, La.; Paul E. Farrier, Chicago 90, Ill.; Lawrence B. Green, Boston, Mass.; James B. Howe, Seattle, Wash.; Erwin N. Griswold, Cambridge, Mass.; James C. Ingebretsen, Los Angeles 18, Calif.; James S. Y. Irvin, Washington 5, D. C.; Paul Jackson, Dallas 1, Tex.; H. C. Kilpatrick, Washington 5, D. C.; Harry J. Rudick, New York, N. Y.; Weston Vernor, Jr., New York, N. Y.; and Robert Vincent, New York.

This bill provides that that is the 1942 act—all community property in the community property States shall be taxed to the first spouse to die, except in two respects: First, except that property which is attributable to the earnings of the surviving spouse; and second, except such community property as was attributable to the separate property of the surviving spouse. All other community property, except those two categories, were to be taxed altogether to the first decedent, whether it be man or wife, with a proviso that in any event, whether the decedent originated it or not, property over which he had the testamentary power of disposition should be taxed.

The simple case that the draftsmen had in mind was the case of the lawyer, for example, who through his own efforts accumulated some wealth. The wife was a housewife and contributed nothing in the economic sense. The theory of this act was that should the husband die first in those circumstances he, being economically responsible, should be taxed on the whole of the wealth, whether or not he owned it or whether or not he could transmit it.

However, if the wife, perchance, should be the first to die, under those same circumstances in the community property States she was to be taxed on that which she could dispose of at death, namely, one-half. So we have the concept of all of it being taxed to the husband if he should die first but half being taxed to the wife if she should die first.

This bill produced a series of inequities as far as we are concerned.

Senator LUCAS. It did violence to your community property laws.

Mr. JACKSON. It did. I do not need to labor the point too much, but to illustrate a point or two: We have in Texas, we will assume, a man and wife who married 40 years ago. The wife brought into the community separate property of her own. The husband brought into the community separate property of his own. Now, under our law in Texas, the income from that separate property is community. The income from her separate property and the income from his separate property are both jointly owned under our State law.

And in recognition of that State law the common practice of such a man and wife would be to deposit their joint earnings—that is, the incomes from their respective properties—into a common bank account. From that common bank account investments would be made. Those investments were community property under our law. Those investments, in turn, produced income, and other properties were sold, and they were mingled in this common bank account with the earnings of either spouse. And in the course of 40 years they accumulate in that way an estate. Then one of the spouses dies.

Now, this law says that the whole of that community—every item of that community property on hand at death shall be taxed to the first spouse to die, whether it be man or wife, except that which is traceable by the executor into the separate property of one or the other of the spouses.

Now, our executor whom we represent takes the list of community property on hand at death and undertakes to make this tracing. And he finds that here is an item of community property that was acquired in 1940. And he finds that that property acquired in 1940 was purchased with a check drawn on this common bank account. He goes into that common bank account and he tries, with the aid of account-

ants, to see what went into that common bank account; that is, the community fund that was used to purchase this property. And he finds that years before, through many changes, mutations, withdrawals, and additions and subtractions, she put in some and he put in some, but they do not know how much is ascribable to each.

It is impossible in those circumstances to trace this item of community property acquired in 1910 back to its original sources, yet this statute places upon us the burden of taking each item of community property on hand at death, whether the death be of the husband or wife, and tracing its origin back through 10 or 50 years of married life, an impossible burden of proof.

Senator LUCAS. If you do not do it, then the Treasury officials come among and attempt to do it.

Mr. JACKSON. Yes. And we have an arbitrary method of taxation which, too frequently, leaves the amount of the tax to the liberality of the revenue agent.

The CHAIRMAN. I think it should be said that while this new concept of the 1942 act did violence to the system of property in the community property States, it was a concept, though, that prevailed in the common law States so far as joint tenancies and tenancies in entirety were concerned.

Mr. JACKSON. That is true.

The CHAIRMAN. And it was an attempt, even though misguided, to bring equalization between the two systems in that limited field.

Mr. JACKSON. That is true.

The CHAIRMAN. When it was attempted to do the same thing as far as splitting incomes were concerned, we ran into difficulties in Congress which never could be overcome.

Mr. JACKSON. It is true. I think the principle is the same, Senator Millikin; yes. But it is one thing to tax at death in accordance with economic origin in joint tenancy or tenancy by entirety, which is created by a single voluntary act, and which is generally a matter of record, its origin easily traceable; and it is something else again to apply that rule indiscriminately to every item of property that man and wife accumulate over a long married life.

The CHAIRMAN. I believe that is very correct, and I quite agree that it certainly was not consistent with your theories of property in community-property States.

Mr. JACKSON. Here is one difficulty of applying their concept of economic attribution. It is a difficulty of definition. In seeking to achieve this result of taxing the creator or originator of wealth, this statute taxed community property to the first to die, except community property attributable to the earnings of the surviving spouse—that is, compensation for personal services actually rendered—or attributable to the separate property of the surviving spouse. That definition has created some very curious results.

A man, for example, in Texas, incurs what we call a community debt. It is a debt of the husband and the wife. With that debt they purchase an item of property. That property enhances in value, and the income therefrom, which is community, pays off the community debt, and then one of the spouses dies. Who in that case under this statute is economically responsible for the property? Under our definition that property is not derived originally from the separate

property of either spouse; it is not derived originally from compensation for personal services rendered by either spouse, and thus we have an item of property which is taxed, under the statute, altogether to the first spouse that might die.

Or take our rancher or farmer; a man and wife come into the marriage 40 years ago with no property. They bought a farm on credit. They worked hard and diligently together and they accumulated a little estate. One of the spouses dies. Under this statute that man and that wife have community property, yet it cannot be said that their community property is derived originally from the separate property of either spouse, because they had none.

It is not derived originally from compensation for personal services rendered by either spouse, because they did not work for anybody; they worked for themselves.

So you have a category of community property which would be taxed under this statute altogether to the first spouse to die.

The CHAIRMAN. As an administrative matter, it must have been very confusing.

Mr. JACKSON. Very confusing. The confusion resulted from trying to interpret this phrase: "compensation for personal services as actually rendered." We could give you innumerable instances, some rather amusing, of how this thing has operated.

It has placed upon us burdens of proof and of tracing, impossible to bear. And it has caused people to be taxed on property in Texas, not owned by them, over which they have no power of disposition at death, and property with respect to which they are not even economically responsible.

Senator LUCAS. Do you have the figures to show what this act of 1942 produced in the way of revenue for the Government?

Mr. JACKSON. I do not know. It said that the retroactive repeal of this statute would cause a loss in revenue of from \$70,000,000, and I heard another figure of \$90,000,000. I do not know how those figures were arrived at.

Senator LUCAS. Per annum?

Mr. JACKSON. No. For the whole 5-year period.

Senator GEORGE. You mean to make it retroactive to 1912?

Mr. JACKSON. Yes, sir.

Senator BREWSTER. In the report on this bill in the House, I am not clear to what it applies. It says:

Moreover, the Secretary of the Treasury advised the committee that if all married couples took full advantage of this provision the combination of such estate and gift tax changes would involve an annual loss in revenue amounting to \$215,000,000.

Are you familiar with that?

Mr. JACKSON. Yes, sir. That figure, Senator, refers to the total annual loss in revenues all over the United States. That figure, I think, refers to the equalization provisions in the bill which would accord to the common-law States the same right to split their property at death, the provision that would enable a man through the use of the marriage exemption to give half of his property to his wife.

Senator BREWSTER. The report is not clear. It speaks of H. R. 4790 in its present form, repealing the 1942 amendments referring to community property. Then it speaks of certain amendments. Were

those in **the** House bill, or does this statement apply to the **House** bill without **the** amendments?

Mr. **JACKSON**. One of **the** amendments referred to, **I** think, is the amendment dealing with credit to property **previously** taxed. **I** do not know if that figure refers to the loss before or after.

Senator **GEORGE**. **I** think it refers to the bill as amended in the **House**.

The **CHAIRMAN**. They did not have time, Senator, to **get** the amendments in the original bill as reported to the **House**, so it was brought in by way of amendments in the **House**.

Senator **BREWSTER**. On floor amendments?

The **CHAIRMAN**. On floor amendments.

Senator **BREWSTER**. This loss of \$245,000,000 applies to the bill with the **House** amendments? Is that your understanding?

The **CHAIRMAN**. You are speaking of the retroactive feature?

Senator **BREWSTER**. No. This is current, **I** understand. That is what the revenue would be each year.

Mr. **JACKSON**. That is what the revenue would be each year, including the common law and community property.

The **CHAIRMAN**. Mr. Stain tells me it is the future operation.

Senator **BREWSTER**. Yes. That we would lose annually about one-third of the revenue from the estate tax.

Mr. **JACKSON**. The bulk of that is attributable to the common-law States, this equalization provision; because if the retroactive repeal would cost from seventy to ninety million dollars over a 5-year period, that would be, roughly, fourteen to eighteen million dollars a year in the community-property States. #

Again **I** do not know whether this figure that has been given, of seventy to ninety million dollars, is the correct figure.

The **CHAIRMAN**. **I** may say **I** think our staff calculates it at around \$100,000,000 and the Treasury somewhat higher.

Mr. **JACKSON**. The retroactive?

The **CHAIRMAN**. Yes. That is what **I** am talking about, the retroactive proposal.

Mr. **JACKSON**. **I** would like to raise this question and perhaps talk to the staff about that figure. If that figure of \$100,000,000 represents the aggregate of refunds that would be allowed under retroactive repeal, then **I** think that figure should be adjusted to take into account the fact that on the death of the surviving spouse later there will be a recapture of a part of that revenue loss, whether the wife dies within the 5-year period or beyond the 5-year period.

For example, here is a man who died in a community-property State with a million-dollar estate. The tax on that is \$345,000.

Senator **BREWSTER**. You did not say he died of a million-dollar estate.

Mr. **JACKSON**. Owing. He died with a community property estate of a million dollars, half of which was his and half his wife's. If the statute is repealed retroactively he would seek a refund with respect to the inclusion in his estate of the surviving wife's share. That refund would be approximately \$130,000 of the \$325,000 that he paid.

Now, that \$130,000, while immediately refundable without interest, under a retroactive repeal, should be reduced by the amount of tax that will be collected from the surviving spouse on her half, whether she dies within or without the 5-year period.

Assuming no change in values she dying later, with a \$500,000 estate, would pay approximately \$180,000. So that while the refund to the husband will be \$180,000 the Government will recapture on her death later, \$145,000 of that \$180,000.

The CHAIRMAN. The prospective cost, of course, would be reduced if we should reduce the amount of proposed reduction in the Knutson bill. Obviously if we should have a bill that would reduce our taxes say between four and a half to five billion, the prospective cost of these provisions would be less in the future, would they not, than they would under the Knutson bill?

Senator **GEORGE.** Not under this bill.

Mr. JACKSON. I do not think the estate or gift taxes would be affected.

Senator **LUCAS.** It would be worth a hundred million dollars to get out from under this, would it not?

Mr. JACKSON. It would certainly be worth a hundred million dollars to us in Texas.

Senator **BREWSTER.** Taking your example a little further, if the \$180,000 were refunded, that would immediately become part of the community property, would it not?

Mr. JACKSON. If it were paid by his estate, it would be recovered by his estate.

Senator **BREWSTER.** What would happen to it then? Where would it go?

Mr. JACKSON. That is a very difficult question, unanswered yet in Texas. We do not know, in Texas, yet, whether under this 1942 act the burden of the Federal estate tax is to be borne by the decedent's estate all together, or whether it is to be apportioned between the decedent's estate and the surviving spouse. We do not know whether the \$345,000, for example, is a liability altogether, of the decedent's estate, or whether that liability is apportionable between the decedent's heirs and the surviving spouse.

Senator **BREWSTER.** Is that in litigation now?

Mr. JACKSON. That is in litigation, to be straightened out.

In Louisiana, after some litigation, the Supreme Court of Louisiana held that it was apportionable, that is, that the surviving spouse must bear her share of it. The revenue agents in Texas take a different view. They think that this is a liability of the decedent. So much so that if the surviving spouse should voluntarily pay half of the tax, they charge her with a gift tax on the estate tax that she has paid, on the theory that she is paying somebody else's liability.

The CHAIRMAN. Let me state a little more accurately what I misstated awhile ago. If we should reduce the amount of reduction of the Knutson bill we are made more comfortable in terms of surplus to bear the cost of this particular feature of the bill.

Mr. JACKSON. We urgently hope that you have that comfortable feeling, Mr. Chairman.

Let me show briefly the impact of these taxes, considering the death of both spouses.

The CHAIRMAN. Before you start on that, are you prepared to make any comment on the ability or duty of the States, or willingness of the States, to make tiny refunds that would be called for in fairness, if we made these provisions retroactive?

Mr. **JACKSON**. We have been assured by Governor Jester, after talking with the comptroller of the **State** of Texas, that they will see to it that the adequate refunds are made and if the legislation presently in the **State** is not adequate, it will be recommended by the Governor.

The **CHAIRMAN**. So far as you know, would we be putting a very heavy burden on any State that might be difficult to meet?

Mr. **JACKSON**. I cannot speak for the other States. But our inheritance tax statutes are very liberal in the sense that the rates are very small. Generally, and in the overwhelming majority of cases, the amount of inheritance tax involved is within the 80 percent credit allowed under the revenue act of 1926.

It is only in a few cases that our inheritance tax exceeds the amount of this take-up statute allowable under the revenue act of 1926. I think that the amounts involved in terms of inheritance taxes are relatively small, but they have caused us considerable confusion and trouble in Texas.

The comptroller, who collects inheritance taxes, still does not know whether the additional inheritance tax, which is brought about by including the surviving spouse's interest in the estate is constitutional or not. In Texas, that amount has been held in a reserve or suspense fund pending the outcome of this matter.

On the matter of the monetary effect of the 1942 amendments. I would like to present to the committee this comparison, this illustration to show how the 1942 amendments operate in the community-property States to disadvantage of the community-property taxpayers.

Let us assume that in New York, which is a common-law State, a man accumulates a million dollars of property through his own efforts. And let us assume that in New York he leaves the typical type of will, the will which is standard procedure in New York, where a man has any property of any consequence, and that is the income from this property shall be paid to his wife, for life, with remainder at her death over to the children. That is a universal type of disposition in all States.

Now, that man in New York, who accumulates this million dollars, pays at his death an estate tax of approximately \$325,000. The wife dies later. There is no second tax at her death, because she has a life estate which merely terminates with her death. And so in New York this property accumulated by this man bears a total of \$325,000 of taxes on the death of both spouses.

Let us take that identical situation in Texas. A million dollars is accumulated by this man in exactly the same way. He leaves the identical will, namely, all my property to my wife for life, remainder at her death to the children-and he dies.

Under the 1942 amendments the same tax is collectible as was collected in New York, namely, \$325,000. But here is where our local law operates: that man may not dispose of his wife's half interest in that property. He cannot give her a life estate in that which is already hers. She must receive that half outright, with the result that though he leave the same will, regarding the same property, accumulated in the same way as the man in New York, the wife at her death later must pay a tax on her half, and that tax is roughly \$145,000.

Senator **BREWSTER**. That is the effect of the 1942 amendments, is it?

Mr. **JACKSON**. That is the effect of the 1942 amendments.

Senator **BREWSTER**. And is there no way by which he can avoid that tax?

Mr. **JACKSON**. He cannot avoid it, even though he attempts to put her to an election, and undertake to give her a life income in the whole of the community in lieu of her half interest. She, at her death, has the absolute right to refuse to take under any such will and may take under the law. Moreover, even if she elected to take under such a will, the Treasury Department says—I think very properly so under the law—that her voluntary election made at his death to accept the benefits of his will, in lieu of her community interest in the property, is the creation by her of a trust, an intervivos trust, under the terms of which she is to receive income for life, and under the Hope amendment she is to pay a tax at her death.

She has not a transfer by virtue of her voluntary election to a trust, under the terms of which she receives income for her life, and of course, as we know the Hope amendment provides that any intervivos transfer by any decedent, of property in trust or otherwise, under the terms of which he retains the use, enjoyment, or income for life, is taxable at the transferor's death.

Senator **BREWSTER**. It is your idea that the only solution is repeal, that there is no other amendment which would take care of that situation?

Mr. **JACKSON**. I think repeal is the only way that we can eliminate all of the burdens and hardships, this tracing problem, and so on.

We have tried time and again to conceive of a series of amendments that would correct this problem. We took it up with the common law people and that was the first approach to the problem of letting the 1942 amendments stand and trying to amend it. And we found we got into so much trouble that the only fair solution was to repeal it and start all over again, and thus we have this equalization bill.

Let us carry our million-dollar case a step further. Let us assume that this man in Texas, who had accumulated this million dollars, was in the oil business and let us assume that this million dollars of community property was all oil property, which he had discovered, and therefore had a zero, or nominal basis, in his hands so far as cost is concerned. That man dies. The tax, as I say, the estate tax is \$325,000 under the 1942 amendments. It becomes necessary to sell that property at his death to pay this estate tax. When the wife sells her half interest for \$500,000, under section 113 (a) (5), the basis of that half is cost, which is zero. Thus she pays a capital gains tax of \$125,000, which is not payable by the New York oil discoverer, if they have oil in New York, or Pennsylvania, or any other common law oil State, because in those cases where death occurs, there is a step up in basis of the property at death.

But not so as to the wife's half interest in the community property in Texas. And that is because 113 (a) (5) simply says that the property acquired by way of devise, bequest, or inheritance shall receive the value at date of death.

But in community-property States the wife's interest is not derived by way of bequest, devise, or inheritance. She has owned it all along and therefore 113 (a) (5) does not apply to that situation.

Thus we have in Texas, then, the decedent paying \$325,000 of estate taxes, the wife possibly paying \$125,000 of capital-gains taxes, and then later, when the wife dies, another tax of perhaps \$145,000 as against only the single tax in New York of \$325,000.

In other words, we pay 80 percent or more, or 85 percent, more taxes in certain cases, of that kind, in Texas than the people under identical situations would pay in New York.

Senator BREWSTER. How much have you made out of this community-property provision meanwhile?

Mr. JACKSON. I did not understand the question.

Senator BREWSTER. How much have you made out of this community-property provision meanwhile? I am speaking about the whole effect of the community property. I am thinking now of the inequities which you allege and how advantageous it has been. We have heard a great deal of the other side of it, how profitable it was to you to have this provision.

Mr. JACKSON. Let us see the monetary effect, leaving aside the difference in State law, and the burden that the husband bears, the greater rights of the wife, and all of those things. Let us look at the dollars and cents of it. Take the million-dollar case again and assume we have no 1942 amendments. And see what was the advantage that we had in Texas over the man in New York.

In New York the millionaire died and the tax was \$325,000. He left again the typical will: Income to his wife and remainder over, income tax on the death. Total tax at the death of both spouses, \$325,000.

Before 1942 what was the situation in Texas? Property accumulated in the same way, amounting to \$1,000,000, was all community. The husband died and left the same will: Income to the wife for life and remainder over. But his tax at that time was only on \$500,000, which was about \$145,000. The wife dies 5 days later or 10 years later. Assuming no change in values, the tax on that \$500,000 was again \$145,000. The sum total of these two taxes, in Texas, because they were split in two equal parts because he owned them equally, was \$290,000, approximately, versus \$325,000 in New York, a difference of \$35,000 or \$40,000, about 3½ or 4 percent of the entire estate.

In terms of advantage it was about 11 percent advantage in favor of the Texan and as against the New Yorker on the death of the two spouses. But the 1942 amendments in that case produced a disadvantage of perhaps 80 to 85 percent to us.

Senator BREWSTER. I wanted to include also the annual advantage of the community-property tax, in trying to appraise how much you had suffered down there—I mean, in the matter of the income taxes as well.

Mr. JACKSON. Those figures I do not have, Senator. I am sure the income-tax advantage is very substantial, yes.

Senator BREWSTER. I think you should bear in mind that you have had great advantages as well as certain disadvantages and I was trying to arrive at an appraisal of the relative position. Perhaps it is not important.

Mr. JACKSON. We do not look upon it as an advantage, considering the nature of our laws, considering the fact that the wife is truly the owner of one-half. We do not think there is really a disadvantage

or an advantage when you take into account that the property laws are essentially different. But it is true that, property laws to one side, the sum total of taxes payable in Texas has been lower than in New York.

The CHAIRMAN. It has been estimated roughly by Mr. Stam that the savings in income taxes to the community-property States, by virtue of their community property, is something in the neighborhood of 80 to 100 million dollars a year, depending, of course, on the income level.

Mr. JACKSON. And that has prevailed upon us to go along with the split incomes. While at first we were opposed to the split-income provisions and opposed it violently because it did not adhere to property rights, we have been persuaded it is a fair and equitable bill, and we do think it is fair.

Now this matter of retroactive repeal for a moment. We think that a retroactive repeal is the only method by which all of these inequities can be removed. It is only by retroactive repeal that we can deal fairly with those people who have been taxed on property not owned, property not transmitted, and property not even economically attributed to them, because of the inability to trace, or because it is a category of community property that is not traceable to either to either of the two categories mentioned in the statute.

It is only by retroactive repeal that we eliminate the confusion in the litigation that exists insofar as the burden of the tax is concerned, and insofar as our inheritance tax in the State is concerned.

And it is only by retroactive repeal that we can get this double tax burden lifted from our shoulders, and correct at the same time the hardship brought about by the basis provision.

The CHAIRMAN. Do you believe that the common-law States would be put in the position to claim that they should have a retroactive readjustment of their burden if this were done, for the community-property States?

Mr. JACKSON. I do not believe so, for two reasons: One is that this whole question was threshed out between the common-law and the community-property lawyers. The American Bar Association, the numerous State bar associations, have recognized that retroactive repeal is proper and they are not asking that the equalization provision likewise be made retroactive.

I think from the standpoint of justice and equity you should repeal these laws retroactively—that is, the 1942 amendments retroactive—and yet make the equalization prospective.

I think you have two questions: One question is to remove an inequity that has existed for 5 or 6 years. I think the removal of these inequities ought not to abide equalization. I think you should equalize in all events and we are urging equalization upon you. We think the problem of equalization is somewhat different from the problem of removing a hardship and burden that has existed on us for 6 years.

I think you should equalize now—from now on. No one is asking that we equalize income taxes back to 1913; no one is suggesting that we equalize estate taxes back to 1916. We have tried to devise for the first time a fair equalization plan that should operate for the future. In addition to providing for that equalization, we think we should have removed from our backs this inequitable law that has been in effect since 1942.

The problem of removing inequities is not necessarily tied into the problem of equalization. I think we have fairly arrived at the proper solution for equalization. I think we are entitled now to have a removal of the inequities.

The **CHAIRMAN**. Could you not argue that since the common-law States did not accept the burdens of the community-property States as of 1942, therefore there is no just ground for retroactive treatment of this new split income?

Mr. JACKSON. I think certainly that a fair-minded taxpayer in New York might well consider a friend in similar situation in Texas. The Texan anticipates the day of his wife's death, realizing that the community property is half-owned by his wife even though the husband may have been solely responsible for it. Half of this property will at his wife's death pass as she directs. She may leave half of the business built up by the husband to in-laws or the children or to strangers. The man in New York is not confronted with that prospect. He runs no risk of his business being disrupted at his wife's death or passing to his wife's devisees. He, therefore, readily realizes that because of these differences in the property laws of the two States the Texan's tax advantage is not such a great advantage after all.

The **CHAIRMAN**. I think that one of the weaknesses in the argument of discrimination against the common-law States is obviously that the common-law States have been unwilling to assume the burdens of the community-property system.

In other words, I have always felt that too much sail could be put upon the argument of discrimination. To my mind the matter is a practical adjustment, due to the rapid increase in States adopting the community-property system, in an ever-enlarging degree, with turmoil all over the country. I put less emphasis on the discriminatory feature than on the practical aspects of the problem.

Mr. JACKSON. I think you are entirely right. I think the word "discrimination" has been too loosely used. I do not think that the prior law discriminated in favor of the community-property States. Certainly there is no discrimination in the application of a uniform rule of estate taxation that applies uniformly to property owned and property transmitted at death. The fact that the wife in Texas may own more than the wife in New York and that may produce a slight tax inequality from the standpoint of mathematics does not mean that the law is unequal or discriminatory.

The **CHAIRMAN**. It is perfectly apparent that the common-law States are making a rush to the community-property system, and an increasing amount of turmoil and uncertainty is being created throughout the country over this tendency, and that I think gives rise to a natural interest which warrants what we hope to do.

Mr. JACKSON. I think you are entirely right, sir. I think it is bad for a State that has had a particular property system for 100 years suddenly to change over to an entirely different system, without the benefit of the great body of law that has been built up around that other system.

The **CHAIRMAN**. Take a highly complex economy like the State of Pennsylvania, and overnight to project into that State a community-property system—the confusions and dislocations are indescribable and incalculable in their ramifications.

Mr. **JACKSON**. That is right. That is why we approach it from this standpoint, not to pass a statute which would be directed specifically at our laws or a statute that would be directed specifically at the common-law States. Leave each State free to adopt its own laws, and not violate the property laws of any State, apply a uniform rule of taxation that would be applicable to all alike but which would at the same time achieve mathematical equality as far as possible.

Senator **GEORGE**. Mr. Jackson, I did not hear your earlier statement. Do you think the equalizing provisions here between the common-law and the community-property States are fair as written in the bill?

Mr. **JACKSON**. We think they are fair. We think they will achieve substantial equality. There are very few instances where perfect mathematical equality will not exist. There are a few instances where Texas will have a slight advantage; a few instances where New York will have a slight advantage. But they are unique cases.

In the main—and we have compared dozens and dozens of illustrations—in the main this statute will operate equally and uniformly. It is based on the simple principle that our wife, wherever she may be—whether in New York or Texas—and whatever she receives, up to one-half of the estate; whether she receives it by virtue of the community-property law, whether she receives it by virtue of the law of the dower or the law of intestacy, or whether she receives it by devise or bequest—however she gets it, by whatever operation of what law that property, up to the extent of one-half of the estate, will be free of tax at the husband's death, the tax on her half to be collected at her death later, whether it be 1 day later or 5 years later. It is as simple as that.

Senator **GEORGE**. My understanding is that the husband gives outright the fee to the wife, one-half of the estate, then his estate is taxable only on the remaining half.

Mr. **JACKSON**. That is true.

Senator **GEORGE**. And if he gives to the wife one-half of the estate with full power of appointment, the same rule applies.

Mr. **JACKSON**. The same rule applies; yes, sir.

Senator **GEORGE**. Is that your interpretation?

Mr. **JACKSON**. That is my interpretation and the idea was to put the people in the common-law States on an equality with the wife in the community-property States at death. What she receives in the common-law States, whether by virtue of the dower law; by virtue of intestacy, or by virtue of devise or bequest, if she has that property outright or its equivalent through power of appointment, if she owns that half outright that half will not be taxed at he husband's death, but that half will be taxed at the wife's death. Thus you get mathematical equality except in a very few rare instances.

I would like to revert for a minute to Mr. Snyder's statement last Monday where he says that this bill will produce some inequalities. He mentions a few rare, unique cases where that would be true. He failed to tell the committee that in the overwhelming majority of the cases complete mathematical equality is achieved. He also failed to tell the committee that in those rare cases that he did enumerate, in those instances that are cited at page 10 of his report, under the 1942 amendments the same inequalities that he refers to are present under the 1942 amendments, and indeed, in certain cases that he refers to, there

is a greater inequality under the 1942 amendments than there will be under the present bill.

It is strange to me that the Secretary of the Treasury should come before this committee and urge retention of the 1942 amendments and oppose the adoption of this equalization bill, when this equalization bill, and the repeal of the 1942 amendments, are verbatim parts of the Democratic bill that was introduced by Congressman Rayburn in the House on a motion to recommit.

I cannot understand why the Secretary opposes the very measure which the Democrats advocated in the House.

Senator GEORGE. Perhaps with the thought that the motion to recommit would not prevail.

The CHAIRMAN. I may say as far as the Senate is concerned, I do not believe we had what might be officially called an administration bill last year. There was great interest on the Democratic side on a split-income provision.

Mr. JACKSON. I would like to see this made a nonpartisan measure. I think it is so fair and so equal that from the standpoint of the American Bar Association I would like this thing to be looked upon as the first real attempt to do away with this problem that has plagued Congress, has plagued the representatives of the various States, for over 25 years. I think here is our first real opportunity to solve this troublesome problem.

I deplore the fact that the Secretary of the Treasury comes in and tries to oppose it, making the very captious objections that he does. In fact, in his report he recognizes that under the 1942 amendments there exists inequality; he does not purport to tell you how those inequalities can be cured; he admits that there are differences now existing under the 1942 amendments, and he says those differences can be narrowed by some amendments.

But he does not say what those amendments are; he does not tell to what extent the differences that he recognizes can be narrowed. We have had this law with us now for nearly 6 years, and at no time has the Secretary or any of his assistants made any suggestions as to how these differences that he now recognizes should be narrowed, much less eliminated.

On the question of retroactivity there has been a constitutional question raised. The constitutional question is this: If the 1942 amendments are repealed retroactively, it is said that that will revive a tax against the surviving spouse's estate, or against the other spouse—a tax that did not exist under the 1942 amendments.

For example, a man in the community-property States makes a gift of community property. Under the 1942 amendments that whole property is chargeable to the husband, and the husband pays the gift tax thereon, the wife paying no gift tax.

Now, if the amendments were repealed retroactively the husband would be allowed a refund with respect to the gift tax paid on account of the wife's interest in the community property. But this retroactive repeal, it is said, will reimpose or revive a gift tax as to the wife, which tax was not paid on her under the law prior to retroactive repeal. Thus you have a retroactive tax, which gives rise to the question of constitutionality.

If you do not reimpose the tax on the wife, then it is said that there is a windfall or an escaping of tax altogether on the half on which the wife should have paid a tax.

The objection is not serious, in my mind. I think the answer is rather simple. First, to provide that the retroactive repeal shall not serve to revive or create on the other spouse a gift-tax liability that did not exist under 1942 amendments, so as to remove the constitutional question.

And then to provide that in case a refund is sought, that refund shall be reduced by the amount of the tax that the other spouse should have paid under those circumstances.

If you limit his refund by what the tax should have been, had the 1942 amendments never been enacted, I think you eliminate the constitutional question and you avoid, in the great majority of cases, those of any consequence, any escaping of tax or any windfall.

It could be provided, for example, in connection with the retroactive repeal, that the tax liability of whoever is the taxpayer, the husband in this case, with the repeal of the 1942 amendments shall continue and that liability shall be what the tax liability would have been had the 1942 amendments never been enacted.

The CHAIRMAN. Is this not the point of caution: We must be careful not to impose a retroactive burden. We can impose retroactive benefits, but the constitutional question does not arise unless we impose retroactive burden.

Mr. JACKSON. That is true.

The CHAIRMAN. And if we avoid that we will avoid constitutional questions. Is that the whole point?

Mr. JACKSON. That is the whole point. That is true.

If the impact on the revenues is deemed to be so important as not to justify retroactive repeal, perhaps the committee would like to consider a possible substitute to retroactivity that would give us a measure of relief in the community-property States. A possible substitute for retroactivity would be a bill that would contain two parts. One part would be to give the surviving spouse a credit to be applied against the surviving spouse's estate tax later, a credit equal to the tax that was paid on the first death.

That provision would eliminate the double tax feature that I referred to. It would serve to eliminate the impact of that second tax on the survivor's death. It would give to the survivor a credit equal to the tax that was paid on the first death. That would remove one of the burdens of the 1942 amendments, short of retroactive repeal.

The other possible substitute would be a retroactive amendment to the basis provision, that is section 113 (a) (5). If a man has died in Texas since 1942 under 113 (a) (5), only half, that is the decedent's half of that property, carries as its basis the value at the date of death. The other half, the surviving spouse's half, carries with it original cost.

Now, where a man has died since 1942, and property has been sold or will be sold, it seems only fair that the surviving spouse's interest which has been subject to estate taxes, should receive as its basis the value at the date of death. Otherwise we have a duplication of taxes. We have both an estate tax on her share and a capital gains tax when she sells her share later. Certainly the property that has been subject to estate tax should carry as its basis the value at date of death.

The **CHAIRMAN**. The staff asked me to inquire how about the effect of a retroactive repeal on increasing the wife's liability for future taxes with respect to future gifts?

Mr. **JACKSON**. I would assume, if this were repealed retroactively, it would have this effect. Let us assume that in 1945 a gift was made of community property of \$20,000. If the statute is repealed retroactively, I take it that the husband, first, would secure a refund of the \$10,000 representing the wife's share of that gift and he would recover the gift taxes paid on that \$10,000.

In order to avoid the constitutional question you would not retroactively tax the wife on account of that gift of \$10,000, but while you would not retroactively tax her, if they make gifts in the future, I would say that in the computation of the future gift tax the husband's prior net gifts would be \$10,000, and the wife's prior net gifts would also be the \$10,000.

I think the retroactive repeal would serve to increase the bracket in which future gifts would be made by either party, thus increasing the gift taxes to be collected at a later date. But it would not serve to reach back and tax her on that transaction.

It is a gift that she has made, and I think that gift would properly be taken into accounts in determining future gift-tax liabilities.

One thing more about the basis for the future. Mr. Higgins has referred to that. I will not dwell on it long. But it is to be noted that the Secretary of the Treasury himself recognizes that the present bill in failing to amend section 113 (a) (5) for the future, does operate to produce unequal taxes as between the common law and the community-property States on the sales of property.

It is quite obvious that if we have an equalization bill which equalizes income taxes, and have a particular provision in that bill which equalizes gains on the sales of property, that you cannot have equal capital gain and equal income taxes, unless you have equal basis as well.

Now, certainly the basis for determining gains in the sales of property after death should be the same in all States. The Secretary suggests that equalization can be achieved by eliminating section 113 (a) (5) altogether from the code, and relegating everybody, in the common law and community-property States alike, to the original cost, without regard to the value of property at death. That would produce equality.

But I think it would be unwise, for two reasons: I think 113 (a) (5) had for its object two purposes: (1) To assure that there would not be a duplication of taxes, that is, if one has to pay an estate tax on property at death, that property ought not to carry with it a capital gain tax in the case of necessity of sale to pay the estate tax and therefore the basis should be the value at death.

The other reason is in the nature of statute limitations. If we adhere to the original cost, and a father left his property to the son, and the son left it to his son, and in each case, on the sale of that property many years later, you had to go back to original cost, without regard to values on the death of any of the preceding owners, you have extreme difficulty in your proof.

And I think it was for that reason that Congress in its good judgment inserted the provisions of section 113 (a) (5).

We in the community-property States do not care how it is equalized, whether you take away from the common-law States the basis at death for the property that passes estate tax free to the surviving spouse, or whether you give to the community-property spouse the same basis at death for that property which she receives under the community property law, estate tax-free. Either way would produce equality. But it is certainly necessary that it be equalized.

I think, with Mr. Higgins, that the quickest, simplest, easiest method to equalize the 113 (a) (5) provision would be to add a simple provision that hereafter property of the surviving spouse in a community-property State shall, for the purpose of section 113 (a) (5), be deemed to have been received by her or him, by way of devise or inheritance.

The CHAIRMAN. Have you submitted that to the staff?

Mr. JACKSON. We have submitted to the staff bills incorporating our suggestions.

The CHAIRMAN. Have you had any reaction from the staff as to this particular matter we are now talking about?

Mr. JACKSON. Favorable, I think; yes, sir. They were very receptive. They believed this should be done. I do not want to commit Mr. Stam on that, but that was the impression I got.

I might say that we have had the finest possible cooperation from your staff. It has been indeed a pleasure to work with them.

The CHAIRMAN. I might say that you have given the staff the finest cooperation.

Mr. JACKSON. We want to continue to work in that capacity.

In closing I would like to say this: I have received today through the mails a letter from Mr. J. C. Kimball, who is chairman of the California State Bar Tax Committee. The tax committee met last Friday or Saturday in California. They endorse this equalization bill, including the retroactive repeal provision and including the basis adjustments that I have referred to.

They have one or two minor and more or less clarifying amendments that they are suggesting. We have just gotten this in this morning. I would like to have the privilege of submitting this memorandum for the record in order that it may receive the consideration of Mr. Stam and the committee.

The CHAIRMAN. It will be put in the record.

(The memorandum referred to follows:)

MEMORANDUM OF CALIFORNIA STATE BAR TAX COMMITTEE IN SUPPORT OF CERTAIN AMENDMENTS TO SECTIONS 301 AND 302 OF THE REVENUE BILL OF 1948. H. R. 4790

1. Under the bill as it now stands, community property acquired before July 29, 1927, by spouses residing in California is treated differently than other community property and is not entitled to fully marital deduction and, in addition, is included 100 percent in the gross estate. The reason for this is that in *U. R. v. Robbins* (269 U. S. 315), the Supreme Court held that California community property as it existed at that time was to be treated as the separate property of the husband for income-tax purposes. This decision was also followed for estate-tax purposes. Shortly thereafter, namely, on July 29, 1927, the California Legislature enacted section 101a of the Civil Code, which declared that "the respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing, and equal interests * * *." In *U. S. v. Malcolm* (282 U. S. 702), the Supreme Court held that community property acquired in California after July 29, 1927 was taxable equally under the income-tax laws to husband and wife. This decision was followed for estate- and gift-tax purposes.

The consequence is that if the 1942 amendments are repealed without any special provision being made, post-1927 California community property will be included in the gross estate only to the extent of half thereof, whereas pre-1927 community will be includible 100 percent in the taxable gross estate of the husband. At the same time pre-1927 California community property in community property and undoubtedly would be included in the term, "community property under the law of any State, Territory, or possession of the United States" found in section 801 (e) (2) (B). Therefore this type of community would be deducted from the gross estate for the purpose of computing the marital deduction but would be included in the gross estate so as not to be included. This type of property would therefore be, it is believed, the only type of property in the United States which would be includible entirely in gross estate and for which no marital deduction would be allowable.

It is believed that the following amendments if inserted in the bill would place pre-1927 California community property in the same status as other type of community property, which in view of the over-all purposes of the bill seems to be justified.

(a) In section 301 (c) (2) (B), after the phrase "if the decedent ... This surviving spouse at any time held property" and before the phrase "as community property under the law of any State," insert the following: "in equal interests."

(b) In section 301 (c) (3), add the following provision:

"(1) Such interest was a mere expectancy which vested on decedent's death."

2. With the addition of section 302 to the House bill, which was one of the floor amendments, the following situation has been created which discriminates against community property. If a wife in a community-property State predeceases her husband, 50 percent of the community property is taxable in her gross estate. Should she leave her property to her husband, his entire gross estate will be taxable on his death, including the property inherited from his wife, which constituted community property before her death, without any benefit from a deduction for property previously taxed. Thus, in the community-property States where the wife dies first and leaves the husband in possession of all the community property, 50 percent of the community property is taxed twice and the remaining 50 percent is taxed once. No comparable situation exists in the common-law States. If the wife dies first in the common-law States, there is no tax unless she possesses a separate estate. If the community-property States if the wife possesses a separate estate, there is a tax to the same extent that there is in the common-law States. Accordingly, where the conditions in the two types of States are the same, namely, where the wife dies leaving a separate estate, the taxation is the same regardless of geographical location of the decedent. Where the wife dies without leaving separate property, however, there is a tax in the community-property States but none in the common-law States. Since the purpose of the bill is to obtain geographical uniformity in tax incidence without regard to the peculiarities of local law creating special property rights, the peculiarity of law in the community-property States in vesting a wife with half ownership of the community which she can will away at death should not be made the occasion for a tax in circumstances where there would be none in the common-law States.

It is believed that the following amendment to the bill would eliminate this inequality:

To section 302 of the bill the following should be added: After the words "The following property" at the very beginning of the new paragraph, added by sections 302, insert the following: ", except property received by decedent from a wife which was their community property,".

It will be noted that the effect of this proposal is felt not only as to the estate tax but also as to the gift tax. If this is not thought desirable, the effect of the amendment can be limited to the estate tax by placing it instead at the conclusion of clause (A) of the paragraph added by section 302.

Another way of achieving approximately the same effect as that sought by the foregoing suggestion would be to allow a deduction under the terms of the marital deduction for all the community property left by a wife to a husband. The effect of this, however, would be to eliminate such property from tax even though the husband survived the wife by more than 5 years. The effect of the suggestion we have made is to subject the property to tax if the survival exceeds a 5-year period. We would have no objection to the inclusion of this property in the marital deduction without limitation, instead of resort to the approach which we have used. However, we have been prepared to accept this relatively minor inequality which exists in the comparatively rare case where the husband sur-

by his wife by more than 5 years. The situation did not become acute until 1932, when the wife died. Accordingly the relief is sought by an amendment to the provision which creates the inequality.

Mr. JACKSON. Thank you, sir.

The CHAIRMAN. Thank you very much, indeed.

(The prepared statement submitted by Mr. Jackson is as follows:)

STATEMENT OF J. P. JACKSON, ATTORNEY, OF DALLAS, TEX., REPRESENTING STATE RIGHTS ASSOCIATION OF HOUSTON, TEX., TO THE SENATE COMMITTEE ON FINANCE

1. The 1942 estate and gift tax amendments affecting community property should be repealed because—

(a) They are discriminatory, confiscatory, and lacking in uniformity.

(b) They represent a direct and hostile attack on the property laws of a few States.

(c) They prescribe one rule of taxation for the common-law States and a different rule for the community-property States.

(d) They violate State rights in that they levy a special, different, and more burdensome tax simply because the marital and property laws of some States differ from others.

(e) They tax one person on another's property.

(f) Man and wife are taxed on the same property, depending, capriciously, on which spouse happens to die first.

(g) They place on community-property taxpayers burdens of proof and tracing origins of property which are impossible to bear.

(h) They create heavier taxes in the community-property States—from 15 to 85 percent more—than in other States.

2. While the income, gift, and estate tax equalization provisions of H. R. 4790 will, for the future, achieve substantial equality of taxation in all States following the repeal of the 1942 amendments, an amendment to section 113 (a) (5) of the Internal Revenue Code is necessary in order hereafter to give to all taxpayers the same basis of property for purposes of determining gain or loss on sales after death. This can be accomplished by providing that the surviving spouse's interest in community property should hereafter have the same basis value at the date of death of the first spouse.

3. In order to remove the hardship and inequities placed on decedents dying in the community-property States since 1942, the 1942 amendments should be repealed retroactively. The objections raised to retroactive repeal are, on examination, without merit.

4. If the amendments are not to be repealed retroactively, the following amendments to H. R. 4790 should be adopted to minimize the hardships and to remove duplication of taxes in the community-property States:

(a) In the common-law States there is usually no second tax on the death of the surviving spouse because of the universal use by the first decedent of the life estate. In the community-property States the 1942 amendment has taxed the whole of the community where one of the spouses has died and the surviving spouse must pay a second tax on his death later. In order to equalize and to remove the burden of this second tax the surviving spouse should be given a tax credit equal to the tax previously paid on this property which has been already taxed on the death of the first spouse.

(b) A retroactive amendment to section 113 (a) (5), is necessary which would provide that where the survivor's interest in community property has been included in a decedent's estate, such property shall have as its basis the value at the date of death. This is necessary because in the common-law States property which has been subject to estate taxes takes the value at death as its basis.

As a member of the special tax equalization committee of the American Bar Association and also as spokesman for the State Rights Association of Texas, I advocate the adoption of the estate and gift tax provisions of H. R. 4790. My remarks will be limited to the community-property aspects of the bill.

H. R. 4790 provides for a repeal of the 1942 estate and gift tax amendments as affecting community property. In fairness to the community-property States and as the first step in the equalization of taxes between the States, the repeal of these amendments is necessary.

These 1942 amendments represented a radical departure from orthodox estate taxation. Traditionally, the state tax had been on property owned by the decedent which was transferred by him at his death. The tax was always a tax on the privilege of transmitting property at death. This traditional concept was continued as to all States save and except the community-property States. As to the several community-property States, a new concept was adopted. For the community-property States, the 1942 amendments undertake to tax a decedent on property which was, in an economic sense, attributable to him without regard to his ownership of such property and without regard to his power to transmit the same at his death. This statute provided that as to property accumulated during marriage in the community-property States, the first spouse to die was to be taxed thereon, whether that spouse was the husband or the wife. Two exceptions were made: (1) Any item of community property that was derived originally from the surviving spouse's separate property; and (2) any item of community property that was derived originally from the wages and salaries of the survivor were to be exempted from tax, provided always that at least one-half or flatover which the decedent had a testamentary power of disposition should be taxed, whether or not the decedent was economically responsible for the property.

This statute produced for the community-property States unequal treatment, hardships, and bizarre results. A few typical examples will demonstrate the effect of this unique statute. Man and wife were married in 1900. Each brought into the marriage separate properties. These properties produced income. The income was community property under local law. The income was deposited in a common bank account and earnings of the spouses through personal services were added thereto. Other properties were purchased from the mingled funds, either in the name of the husband or of the wife. Such properties were community property under local law. These properties produced income and were mingled with other income and with proceeds from the sales of other properties. This process continues over a period of 45 years, and one of the spouses dies. Under the 1942 amendments, every item of community property on hand will be taxed to the first spouse to die unless some item of community property is traceable to the survivor's separate property or separate earnings. The executor undertakes to make this tracing and finds that a particular item of community property was purchased in 1940 with a check drawn on the common bank account. When he undertakes to trace the source of the funds that went into such bank account, he finds that these funds represented a mixture of earlier funds which have lost their identity through commingling and changes, additions, and withdrawals over a period of years. It is impossible in such circumstances to trace the first origins of this property back through all the mutations of the past 45 years. Thus, the whole of the property is taxed to the first to die, whether it be husband or wife, simply because of the inability to prove the origins of the property. This is true even though in point of fact the accumulations of the marriage were partly attributable to one spouse and partly to the other. In disregarding the property laws of the State and attempting to set up this new concept of economic origin, the 1942 amendments place upon the decedents in the community-property States intolerable and impossible burdens of proof, with the result that the decedents are taxed upon property not owned by them, not transmitted by them, and not economically attributable to them.

Take another illustration: Man and wife in Texas borrow money, thus incurring what we call a community debt. With this borrowed money property is purchased. The property enhances in value and the income therefrom, which is community, pays off the community debt. One of the spouses dies. The whole of the property is subject to tax on the first decedent's death, whether it be man or wife, because this property is not, under the 1942 amendments, ascribable to the personal earnings of either spouse or to the separate property of either spouse. No such result is produced in the common-law State.

Consider also the case of the rancher or the farmer. When the farmer or the rancher and his wife were married, they had nothing. They both worked hard and through thrift, industry, and common labors on the farm or ranch, they accumulate together an estate. In the common-law State, the property is taxed to the one who is the owner under State law. But under the 1942 amendments, in the community-property States, the State law is ignored and the whole of the property is taxed to the first spouse to die. Should the wife die first, she is taxed on the property since none of the property is derived originally from the separate property of either spouse or originally from the compensation for personal services actually rendered by either spouse. Similarly, should the husband die first, the whole of the property is taxed to him for the same reasons.

There are innumerable instances of this kind. In all cases where the marital accumulations are not attributable to the separate property of either spouse or to the compensation for personal services of either spouse, the whole will be taxed, under these amendments, to the first spouse to die. Thus, marital accumulations attributable to self-help or self-employment, to speculation, to gambling, to entrepreneur activities, partnership operations, property acquired by way of damages for torts and other claims, property acquired by adverse possession, earnings of minor children, and so on, all represent property which is not attributable to either salaries or separate property, and therefore represent community property which will be taxed altogether to the first spouse to die. Thus, we have a statute which capriciously taxes the husband, should he die first, and the wife, on the identical property, should she happen to die first. Thus, the taxes are made to depend upon the sheer accident of which spouse happens to die first.

One of the greatest inequalities produced by the 1942 amendments is the double estate tax burden which produces a double tax on community property. A comparable tax is not borne by tile taxpayers in tile common-law States. To illustrate, let us contrast the case of a Texas taxpayer with that of a taxpayer in New York. Let us assume that a man dies in New York in 1945 with an estate of a million dollars, attributable to his own earnings. If dies leaving a typical will under which his wife receives the income from the property for her life, with remainder at her death to the children. The overwhelming majority of testators in the common-law States use this device of a life estate so as to avoid the second tax on the death of the serving spouse. At its death, the whole of tile estate is taxed and the tax is \$325,000 approximately. At the wife's death later, there is no tax on tile cessation of her life estate. Thus, on the death of both spouses, the total tax paid is \$325,000. Assume this man died in Texas in 1945 with the same estate accumulated in the same way. Assume he left tile same will, with tile income to his wife for life, remainder to the children. Under the 1942 amendments, the whole of the property will be eluded in his estate, and he will bear the same tax as tile man in New York, that is to say, \$325,000. However, the man in Texas can by his will dispose only of his half of the community property. He may not by his will dispose of his wife's interest in the community property. She, under State law, must receive her half of the property outright. There is no way that he can dispose of tier interest or leave her only a life estate therein. Thus, at the surviving wife's death, her half of the estate will be taxed, and the tax on this half, or \$500,000, assuming no change in values, will be approximately \$145,000. Thus, the aggregate of taxes paid on the death of both spouses in New York is \$325,000, whereas in Texas the tax on the two deaths is \$470,000. Thus, the aggregate tax payable in Texas on tile death of tile two spouses is approximately 45 percent more than the aggregate tax payable under the same circumstances in New York.

Decedents in the community-property States suffer another disadvantage under the 1942 amendments which is not borne by decedents in other States. This disadvantage relates to the basis for gain, loss, depletion, or depreciation of property following tile death of one of the spouses. With tile adoption of the 1942 estate-tax amendments, no change was made in section 113 (a) (5) of the Internal Revenue Code which prescribed a new basis for determining gain or loss on the sale of property transferred at death. This basis is tile value of the property on which estate taxes have been paid. The Bureau of Internal Revenue has recently ruled that in the community-property States, the surviving spouse is the owner of the property from the moment of its acquisition and that as a consequence there is no step-up in basis in the survivor's half of the property even though, under the 1942 amendments the survivor's half is taxed on the death of the first spouse to die for estate-tax purposes. The result of this is that where property has enhanced in value, the community-property taxpayers pay heavier income taxes than common-law taxpayers under the 1942 law. If we assume in the million-dollar estate which we have been discussing that the whole of the estate is community property and represents all properties which have a nominal cost to the decedent because he is tile discoverer of the oil, and it becomes necessary to sell the properties in order to pay tile estate tax at the death of the husband, this would mean that the wife's half sold for \$500,000 would bear an additional tax of \$125,000, that is, a 25-percent capital-gain tax on a \$500,000 profit. No such tax would be payable in the case of an oil discoverer in a common-law State because, in those States, tile basis for gain or loss is the value on which the estate tax is laid. Thus, in the community-

property States we have total taxes as follows: \$325,000 estate tax paid on the death of the husband, followed by a second estate tax on the surviving spouse of \$145,000. Plus a capital-gain tax on the sale of property of \$125,000, or a total of \$595,000. This is \$270,000 more than the total of \$325,000 payable in the common-law States. Thus, the Texas taxpayer dying since 1942 may be and frequently are called on to pay in excess of 80 percent more in taxes than tile common-law taxpayer dying during the same period.

The 1942 amendments have also created considerable confusion and litigation in the matter of administration of estates in the community-property States. This relates to the question of who bears the burdens of the Federal estate tax where the survivor's interest in the community property has been included in the estate of the first spouse to die. The question, unanswered by the 1942 law, is whether the decedent's heirs or tile surviving spouse pay that portion of the tax attributable to the inclusion in a decedent's estate of the survivor's interest in the property.

Furthermore, the 1942 amendments created considerable confusion in tile administration and collection of the State inheritance tax. Our State inheritance taxes are tied into the Federal tax in that an additional inheritance tax is levied, measured by the 80 percent credit allowed under tile Federal law. Where the survivor's interest in tile community property has been included in a decedent's estate under the 1942 amendments, this operates to increase Federal estate tax and correspondingly increases the 80 percent credit, and this, in turn increases the State inheritance tax. Our State laws provide that this additional take-up tax equal to the Federal credit shall be borne by those who are legatees and heirs of tile decedent. This means that where the surviving spouse's interest in property be included in tile decedent's estate, tile children and not the surviving spouse, pay inheritance taxes measured by the surviving spouse's interest in the property.

It is apparent that this unique law directed specifically against community-property States, violates at least three fundamental principles of sound taxation.

1. It is directed specifically and exclusively at the community-property States and to those States alone. It selects for peculiar tax treatment the property laws of those States. This, we submit, is an unwise and fundamentally unsound tax policy, and establishes a bad precedent. Laws of property and of marriage should be left to tile several States. Taxpayers, in the several States, should not receive radically different tax treatment from the Federal Government merely because their property or marriage laws may differ from their neighbors. A policy of selecting particular property and marriage laws of a few States for specialized tax treatment lays tile predicate that Congress, through the exertion of its taxing power, may regulate all the internal affairs of each State.

2. The law is unequal and lacks uniformity. For the community-property States, and those States alone, the 1942 amendments levy a tax on tile movable theory of economic attribution. In all other States, only property owned and transmitted at death is subject to the estate tax. Community property is not a different type or class of property. It represents merely real and personal property which a man and wife accumulate during their marriage, and which the State law says they own equally. Had Congress provided that in all States in the Union, all property acquired by either man or wife during marriage, no matter who is the owner under State law, should be taxed to the first to die, the law would have been equal and uniform. But this rule is applicable to a few States only.

3. In taxing a decedent at death merely because he, many years before, is assumed theoretically to have been economically responsible for the property which is not owned or transferred at death results in taxing one person on another's property. This, we believe, is fundamentally unsound.

It is believed that the 1942 amendments directed specifically at and creating unique and specialized treatment for a few States should be removed. They should either be repealed or the same burdens and hardships should, in the interest of uniformity, be extended to tile common-law States.

Everyone who has made an independent and impartial study of tile 1942 Amendments agrees that they should never have been passed. A year ago at Atlantic City, six American Bar Association recommended the repeal of these amendments. This year a special committee of the American Bar Association, composed of 17 tax attorneys, 11 of whom were from common-law States, unanimously recommended retroactive repeal of the tax cut of tile tax section. The tax section of the

American Bar Association unanimously recommended the adoption of this bill, including retroactive repeal. The house of delegates of the American Bar Association unanimously approved and urged its adoption. Many State and local bar associations have recommended the adoption of the American Bar proposal, including the repeal of the 1942 amendments. None has expressed opposition. Recently the committee appointed to advise Congress on revenue revision, headed by Mr. Roswell Magill, of New York, has recommended retroactive repeal. The House Ways and Means Committee has recommended repeal and the House of Representatives has adopted H. R. 4790, which contains a repeal provision. The administration bill introduced by the Democratic leader, Mr. Rayburn, contains provisions identical with the estate- and gift-tax provisions of H. R. 4790, including the repeal provisions.

Apparently, the Secretary of the Treasury stands alone in his opposition to the repeal of the 1942 amendments. It is difficult to understand Mr. Snyder's opposition to the repeal of these amendments, in view of the Democratic bill introduced by Mr. Rayburn in his motion to recommit H. R. 4790 which contained the identical provision to repeal of the 1942 amendments. In any event, it is apparent from the statement made by Mr. Snyder on March 1 that he neither understands the operation of the community property laws nor the effect of the 1942 amendments. On page 7 of his statement he refers to the 1942 amendments as a recognition "of fundamental similarities in family ownership of property in all States." This statement by Mr. Snyder that there is a fundamental similarity in family ownership of properties in all States exhibits a startling misconception of the differences between the common-law and the community-property systems. Certainly there is a fundamental dissimilarity between the community-property law and the common law.

Under the community-property law of Texas, a man and wife are regarded as partners. They are coowners of all properties accumulated during the marriage, whether such accumulations are the result of the earnings of the husband, the earnings of the wife, their joint efforts, or the income from their respective properties. As a coowner, the wife in Texas, on her death, may leave one-half of these accumulations, even though attributable altogether to the husband, to whomever she pleases—to the in-laws, or even to her paramour. If she dies without a will, her half of these accumulations go to her children, though they be children by a former marriage or illegitimate children. The same is true in the case of the husband's prior death. One-half of the accumulations, even though attributable to the earnings or properties of the wife, may be left by him to whomever he pleases, and if he dies without a will, his half goes to his children. During marriage, either spouse may not defraud the other of his interest in the accumulations, and a husband is forbidden to give the community property, even though representing his personal earnings, to another woman. On divorce, the accumulations are divided equally because the parties are regarded as coowners.

These rules are, of course, different from the laws in the common-law States. It is difficult, therefore, to appreciate the statement by Mr. Snyder that there is a fundamental similarity in family ownership of properties in all States. Certainly, there is a fundamental dissimilarity between the law of Texas and the law of New York. In fact, the basic objection to the 1942 act, which the Secretary fails to perceive, is that it not only recognizes the fundamental dissimilarity in the family ownership of property in the several States, but undertakes to give specialized tax treatment to property laws of Texas and other community States because they are dissimilar.

Again, on page 7 of his statement, the Secretary, in referring to the 1942 amendments, states that "it increased the transfer tax liabilities of community-property residents to approximately the level paid by residents of other States, and generally succeeded in equalizing the transfer-tax liabilities among residents of all States." However, any analysis of the practical operation of the 1942 amendment shows how wrong the Secretary is in stating that that law succeeded in equalizing the transfer-tax liabilities among residents of all the States. But it is at least significant to note that the learned Secretary does not contend that the 1942 amendments achieved equality. He states but it increased the transfer-tax liability of community-property residents approximately (though admittedly not entirely) to the level paid by residents of other States, and that generally (but admittedly not altogether) it succeeded in equalizing.

Later on the Secretary admits that under the 1942 amendments "some differences in the impact of transfer taxes on residents of different States remain," thus

acknowledging that the 1942 amendments do not achieve equality. And in this connection he states that the differences "could be further narrowed by relatively simple amendments within the frameworks of the present structure." It is to be observed that he recognizes that there are differences and that these differences can be narrowed by amendments, although not eliminated entirely. He does not purport to advise how these differences may be narrowed, nor does he even suggest that they can be eliminated altogether by any such amendments. Nor does he indicate what these narrowing amendments might be. The community-property taxpayers have been subjected to the burdens of the 1942 amendments for nearly 6 years. At no time has the learned Secretary or anyone within his Department advocated any amendment to which he now adverts or made any suggestions as to how these recognized differences in tax burdens might be "narrowed," much less eliminated. It is submitted that a law so fundamentally unsound and discriminatory cannot be cured by patchwork amendments the nature of which are not even suggested by the learned Secretary.

The repeal of the 1942 amendments will, for the future, remove the hardships and inequities that have plagued the community-property States for nearly 6 years. Their simple repeal would confer a slight estate- and gift-tax advantage to the community-property States—an advantage that grows out of tile difference in tile property laws of the two systems and from the fact that in the community-property States the spouses are equal owners and each may transfer at death one-half of the joint accumulations. The equalization provisions of H. R. 4790 would remove this advantage and serve substantially to equalize estate and gift taxes in all States under the general principle that the estate tax on the half of the property passing outright to the surviving spouse shall be postponed until the survivor's death, whether that property be acquired by virtue of the community-property laws or tile laws of dower, courtesy, intestacy, or by virtue of devise or bequest. Similarly, equality in income taxation is achieved for tile future by the split-income provisions of tile House bill. However, an amendment to section 113 (a) (5) of tile Internal Revenue Code is necessary to do equity and to achieve equality. This has been adverted to by Mr. Higgins. H. R. 4790 presently exempts from estate tax in the common-law States the property (up to one-half) that passes to the surviving spouse, but the property so passing, though free from estate tax, takes as its basis for gain or loss the value at date of death. But under the bill the survivor's interest in community property, though also free from estate tax, carries as its basis original cost rather than the value at death. This is because H. R. 4790 does not amend section 113 (a) (5), and that section provides for a step-up in basis only in the case of property received by devise, bequest, or inheritance. The survivor's interest in community property is not so acquired. In order to achieve equality the surviving spouse's interest in community property should have the same basis as that acquired estate tax-free by the surviving spouse in a common-law State. H. R. 4790 undertakes to equalize all income taxes and contains a special provision equalizing capital gains. But laconic and capital gains cannot be equalized unless the rules prescribing basis of property is the same in all States.

This equalization can be accomplished as suggested by Mr. Higgins, by amending section 113 (a) (5) to provide that property representing the surviving spouse's interest in community property shall be considered, for the purposes of that section, as having been received by way of devise, bequest, or inheritance.

While H. R. 4790 equalizes estate and gift taxes for the future, it makes no attempt to relieve hardships of the past. During the nearly 6 years that the 1942 amendments have been in force, many taxpayers have died in tile community-property States. These have been subject to all the burdens and inequalities adverted to above. Mr. Dunbar of New Orleans will amplify these. It is enough to say here that many dying since 1942 have been called upon to pay estate taxes on property not owned, not transmitted at death, and for which they were not even economically responsible simply because of the impossible burden of proof or because the community property was of the type which, because not traceable to the salaries or separate property of either spouse, was taxable altogether to the first spouse to die. Also decedents have been subject to the double tax burden described above, which, as explained, has resulted or will result on tile death of the surviving spouse and on the sales of property after death in taxes over 80 percent higher than those imposed on similar decedents in the common-law States.

All of these hardships, inequities, and additional tax burdens may be removed only by a retroactive repeal of the 1942 amendments. It is submitted that this harsh and discriminatory legislation should never have been enacted and should, therefore, be repealed *ab initio*. It is to be observed that the American Bar Association has recommended retroactive repeal, as has also the Magill com-

Three objections have been made to retroactive repeal. The first of these objections is that the repeal of the 1942 amendments retroactively might serve in a few cases to revive tax liability on the other spouse or the surviving spouse where no such tax liability existed under the 1942 amendments. For example, if the amendments were repealed retroactively, a husband who has waded a gift of community property and paid gift taxes on both his and his wife's share of community property will seek a refund, without interest, on that part of the gift tax which was paid with respect to his wife's interest in the property. It is said that retroactive repeal will serve to revive the tax liability on the wife's share, she having paid no tax when the gift was made, the husband, for gift-tax purposes, being regarded as the sole owner. This retroactive tax on her is said to give rise to serious constitutional questions. On the other hand, it is suggested that if she is not taxed retroactively, a part of the property, representing the wife's half, on which she has paid no tax, will forever escape gift taxes. This objection is not serious. The objections could be met by a simple provision that retroactive repeal shall not be construed as giving rise to or reviving any tax that was not due under the 1942 amendments. This would remove the constitutional objection. Then in order to avoid a windfall or an escaping of tax, it could be provided that as a condition to the husband obtaining a refund, either the wife shall consent to being taxed or the amount of his refund shall be reduced by the amount of tax that the other spouse or the surviving spouse would have paid had the 1942 amendments never been enacted. A bill has been prepared along this line which we respectfully submit will eliminate this objection in every case of any consequence.

A second objection to retroactivity is that it will serve for the period from 1942 to date to give taxpayers in the community-property States an advantage over decedents dying in the common-law States during the same period. It is true that there would be some slight advantage. The advantage will simply be the natural result of differences in State law and the fact that the spouse in the common-law State owns and may at death dispose of all his accumulations, whereas in the community-property States the spouses own the property equally and may each dispose of half.

Moreover, the tax advantage is comparatively small and is far outweighed by the hardships that will be perpetuated if they are not repealed retroactively. If the amendments are repealed retroactively, the tax advantage to the Texas and other community-property States' decedents will, on the death of both spouses, in the case of a million-dollar estate be \$35,000 or 11 percent in the Texans' favor. But if not repealed retroactively, the double tax burden above referred to will mean in such a case that the Texans on the death of the two spouses pay \$145,000, or about 45 percent more taxes than comparable decedents in New York.

Moreover, where property has been or will be sold after the death of a community-property decedent, a capital-gain tax will be imposed which is not required in the common-law States. This, as shown above, is because of the basis provision hereinabove discussed, and may in the million-dollar estate result in an additional tax of \$125,000 which is not imposed on the New York state. As we have stated, Texans may pay in the aggregate 80 percent more taxes under the 1942 amendments than are payable in common-law States. Certainly, it is better to repeal the statute retroactively and give Texas decedents an 11-percent tax advantage than to repeal prospectively and thus place these Texas and other community-property decedents at a tax disadvantage of more than 80 percent over decedents in other States.

A third objection to retroactive repeal is the impact on the revenue. It has been said that retroactive repeal will involve from 70 to 90 million dollars in refunds. However, the second tax on the death of the surviving spouse, should be taken into account. This would very substantially reduce the total net cost. The actual difference involved should be comparatively small.

In view of the impact on revenues is deemed to be an insurmountable objection to retroactive repeal, the committee may wish to consider a possible substitute to retroactive repeal. Some of the disadvantages and double tax burdens can be removed, short of retroactive repeal by the adoption of two simple amendments to H. R. 4790.

The first of these amendments would be designed to remove the double tax burden or the second tax on the death of the surviving spouse. This could be accomplished by giving to the surviving spouse a tax credit in those cases where the surviving spouse's interest has been included in the first decedent's estate for estate tax purposes. This credit would not be refunded at this time, but would be applied against any estate tax liability on the death of the surviving spouse. This credit would be without interest and would be allowable only to the extent of the surviving spouse's estate-tax liability. This credit would serve to equalize the total tax burdens between all States on the death of both spouses and would remove the double-tax feature.

The second amendment should be to section 113 (a) (5) and would provide that in those cases where a decedent has died since the effective date of the 1942 act and there has been included in the decedent's estate any part of the surviving spouse's interest in community property, and estate taxes paid thereon, that the surviving spouse's interest so included in the first decedent's estate shall receive as its basis for gain or loss purposes the value of the property at the date of decedent's death. In the common-law States, where the property has been included in the first decedent's estate, such property receives a step-up in basis, under section 113 (a) (5). If the 1942 amendments are not repealed retroactively, a similar change in basis should be given the survivor's interest in community property where such property has been included in the decedent's estate and estate taxes paid thereon.

These two amendments to I. R. 1700 will not remove all of the objections, hardships, and burdens referred to above, but they will serve in a degree to remove the double tax feature and that measure serve to equalize taxes on decedent's dying since 1942.

Drafts of bill incorporating the suggestion previously made have been submitted to Mr. Colin F. Stam.

The CHAIRMAN. The next witness is Mr. James B. Howe.

May I inquire, Mr. Howe, how long you anticipate it will take you?

Mr. Howe. Mr. Chairman, it will take me 10 minutes. I was inadvertently placed in front of Mr. Dunbar and I should follow Mr. Dunbar. With the committee's permission, I would prefer, if you would allow, to have Mr. Dunbar first.

The CHAIRMAN. Let me ask Mr. Dunbar.

How long do you anticipate it will take you?

Mr. Dunbar. Mr. Chairman, I have the 1942 amendments to analyze. It will take more than 10 minutes.

The CHAIRMAN. Would it throw you off stride very much if you testified now?

Mr. Howe. No, sir.

The CHAIRMAN. Will you please be seated and give your name, address, and occupation to the reporter?

STATEMENT OF JAMES P. HOWE, ATTORNEY, SEATTLE, WASH.

Mr. Howe. My name is James B. Howe and I reside in Seattle. I am attorney for Washington State Citizens Committee on Community Income and Estate Taxes and I am also a member of the American Bar Association committee on equalization of taxes in community-property and common-law States.

My State—the State of Washington—is one of the eight traditional community-property States. In 1860, when it was still a Territory, my State adopted the community-property system without thought of any tax benefit. The community-property system has been an integral part of its basic law ever since—that is to say, for nearly 80 years.

The citizens committee which I represent was organized approximately 20 years ago and all of its members are residents of the State of Washington. The purpose of this committee ever since its organi-

zation has been to urge that tile community-property laws of my State be taken cognizance of, and be respected, in the Federal tax laws. Thus, the committee is tile States' rights committee committed to tile defense of the coil ity-property system.

In my State—and in other community-property States having similar laws—each spouse has an interest in community property which is real and substantial. The reality of the wife's interest has always been recognized, and has always been respected, in the Federal income-tax laws. In the Federal estate-tax laws the reality of the wife's interest has always been recognized, but since 1942 such interest has not been respected in the Federal estate-tax laws, either in the State of Washington or in other community-property States. We of the community-property States deeply resent this disrespect, since 1942, of our basic State property laws, and we are alarmed by it, not only because of its effect upon our own citizens but also because we believe that if atonem is not made, to the extent that atonement is possible, what was don to the community-property States in 1942 will stand as a precedent which will offer encouragement to tile never-ceasing efforts of those who believe that the answer to everything is more and more centralized power.

We lawyers front the community-property States have been fortunate in acquiring, as colleagues upon the American Bar Association tax equalization committee, men who have taken a statesmanlike approach to the problem of solvii g Federal tax inequalities. They are not men who believe that the Federal power should be used to destroy our property system, because it differs from theirs, nor do we of the community-property States believe that the federal tax laws should deny their system equal treatment because it differs from ours. Both groups believe that the Federal tax laws should be accommodated to the two property systems, so that the Federal taxes of the citizens of the several States will be equal, or as early equal as they can be made, irrespective of residence and notwithstanding difference in local property laws. Each of the two groups is convinced that it is highly desirable that the Federal tax laws should recognize and respect the basic property laws of each State, whether it be a community-property State or a common-law State.

The present Federal income-tax laws recognize and respect tile interests of spouses in income which is community property. The bill now under consideration by Congress, I. R. 4790, contemplates that this recognition and respect will continue, and such bill will remove the income-tax inequality, of which the common-law States have long complained by ~~contin~~ to spouses residing in common-law States by Federal law, such additional privileges as they need in order to enjoy equality of treatment with respect to their income taxes. Thus, local prop. ty laws will be respected and substantial income-tax equality will be attained.

The present Federal estate- and gift-tax laws disrespect the interests of spouses, and particularly the interest of the wife, in community property, and they have done so ever since the effective date of the Revenue Act of 1942. The bill now under consideration by Congress would repeal the amendments to tile estate- and gift-tax laws made by the Revenue Act of 1942, so as to restore the recognition and respect which was previously accorded to the interests of the spouses in com-

unity property by the Federal estate- and gift-tax statutes. Such bill would grant to spouses residing in common-law States, by Federal law, privileges designed and intended to allow them to enjoy equality of treatment with respect to their estate and gift taxes. Thus the estate- and gift-tax provisions of the bill would remove the disrespect shown to the local property laws of the community-property States and at the same time would provide for substantial estate- and gift-tax equality.

The members of the American Bar Association tax equalization committee are not unaware that there are other means by which the Federal taxes of the community-property States and the common-law States could be made equal insofar as money only is concerned, but they do not believe that mere dollar equality is true equality; and it is true equality, insofar as it is attainable, that has been their goal. They do not believe, indeed they are convinced that true equality cannot exist under Federal laws which unnecessarily disregard the basic property laws of any State. This is why even those from the common-law States have been willing not only to agree, but also to recommend, that the 1942 amendments be repealed, and be repealed retroactively.

The bill now under consideration by Congress provides for the repeal of the 1942 amendments, but it does not provide that they be repealed retroactively. We of the community-property States have always regarded such amendments as unjust and oppressive, and we have been offended by them, since the day they were enacted, because of their failure to respect our basic property laws. We believe that we have now demonstrated that such disregard of our State laws was not only unjust, but was unnecessary as well, and we respectfully submit that if the 1942 amendments should be repealed, both justice and the principles of good government require that they be repealed as of the day they were enacted.

The CHAIRMAN. Senator George?

Senator GEORGE. I have no questions.

The CHAIRMAN. I appreciate your having come here, Mr. Howe.

Mr. HOWE. Thank you, sir.

The CHAIRMAN. We will recess until 2 o'clock.

If the remaining witnesses who will testify on this subject will take advantage of the interval to review their remarks, and eliminate any overlapping with the previous witnesses, it would be much appreciated.

Thank you very much.

Thereupon, at 12: 35 p. m., the committee adjourned, to reconvene at 2 p. m.

AFTERNOON SESSION

(The committee resumed at 2 p. m., after the expiration of the recess.)

The CHAIRMAN. The meeting will come to order.

Mr. Dunbar is our next witness.

Mr. Dunbar, will you be good enough to give your full name, address, and occupation to the reporter?

STATEMENT OF CHARLES E. DUNBAR, JR., ATTORNEY FOR THE
LOUISIANA COMMUNITY PROPERTY TAXPAYERS COMMITTEE,
NEW ORLEANS, LA.

Mr. DUNBAR. Charles E. Dunbar, Jr., of New Orleans, attorney for the Louisiana Community Property Taxpayers Committee, and also a member of Mr. Higgins' special bar association committee on equalization.

The **CHAIRMAN.** We are glad to have you here, Mr. Dunbar.

Mr. DUNBAR. Mr. Chairman, in fairness to the committee, and in order to save your time I will only summarize my statement and argument at this time. I would ask, however, that my statement be printed and be available to the committee because it attempts to completely analyze the bill.

The CHAIRMAN. We will put it in the record in full at this point. (The statement is as follows:)

STATEMENT AND MEMORANDUM ARGUMENT SUBMITTED TO THE FINANCE COMMITTEE OF THE SENATE, MARCH 8, 1948, IN SUPPORT OF THE REPEAL OF THE 1942 COMMUNITY PROPERTY, ESTATE, GIFT, AND INSURANCE TAX AMENDMENTS

(Charles E. Dunbar, Jr., John G. Wisdom, New Orleans, La., attorneys for the Louisiana Community Property Taxpayers' Committee)

THE 1942 COMMUNITY PARTNERSHIP AMENDMENTS TO THE INTERNAL REVENUE CODE DEALING WITH ESTATE, GIFT, AND INSURANCE TAXES ARE ARBITRARY, UNFAIR, GROSSLY DISCRIMINATORY, AND CONFISCATORY, AND SHOULD BE RETROACTIVELY REPEALED

It is my purpose to discuss briefly with the committee the necessity for the retroactive repeal of the unfair and confiscatory 1942 community-property estate and gift-tax amendments. The repeal of these grossly discriminatory amendments is provided for in the House bill now being considered by your committee. In addition to the American Bar Association, many State and local bar associations and other organizations have adopted strong resolutions urging the repeal of these amendments. On the question of the repeal of these amendments, lawyers from common-law States and lawyers from community-property States are in unanimous agreement.

The failure of the Members of Congress to understand or anticipate the grossly unfair, inconsistent, and inequitable effect of the 1942 community-partnership amendments is perhaps explained by the method of adoption of the amendments. The amendments, sponsored by the Treasury Department, were hastily adopted in executive session by the Ways and Means Committee in 1942 as a part of an emergency wartime revenue measure. No hearing or opportunity to be heard was given to the taxpayers of community-partnership States to explain and oppose this radical, discriminatory, and confiscatory system of taxation of community partnerships. It is high time for this great legislative body to undo the harm it has done.

The 1942 community-partnership amendments were proposed and submitted to the Ways and Means Committee on the erroneous theory that, if adopted, they would bring about practical uniformity in estate taxes in community-partnership States and noncommunity-property States. We believe that the Ways and Means Committee in 1942, when it approved these amendments, assumed and was under the impression that practical uniformity and equality of taxation was intended and would be accomplished.

As a matter of fact, as we will demonstrate, the amendments were drawn so that, instead of bringing about equality and uniformity, they have, because of the inconsistent theories and principles of the amendments and their practical application, actually resulted in gross injustice, discrimination, and confusion in the community-partnership States.

Instead of estate, gift, and insurance taxes being equalized by the amendments, husbands and wives in community-partnership States now bear a heavier estate-tax burden than husbands and wives in other States. In many realistic respects the amendments grossly discriminate against taxpayers in community partnership States and create corresponding advantage in favor of taxpayers in other States. This discrimination is an inherent vice in the tax amendments—one that follows from failure to realize the consequence of ignoring, as the amendments do, local State laws which in law and fact create ownership in the wife of one-half of the community-partnership property. This fundamental discrimination is further aggravated because the 1942 amendments ignore the State law of ownership as a basis for taxation and substitute new and novel factual tests of taxation only where larger taxes will be obtained by the Government and at the same time recognize and apply the local State community partnership law with regard to ownership when such recognition and application under the facts involved will produce the largest tax for the Government. A simple reading of the amendments will reveal that they contain radical and conflicting theories and principles in applying the estate, gift, and insurance tax which are clearly inconsistent and which have no equitable basis or reasonable justification in principle or practical operation. In short, as we will hereafter demonstrate, the effect of the amendments is to apply either the legal theory or the factual test in each case depending upon which produces the largest tax for the Government with resulting confusion, injustice, discrimination, and confiscation.

WHAT THE 1941 ESTATE TAX AMENDMENT PROVIDE

The amendment dealing with the estate tax (secs. 811 (e) (2), 811 (g) (4) and 1000 (d)) reads as follows:

"(2) **Community interests.**—To the extent of the interest therein held as community property by the decedent and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, except such part thereof as may be shown to have been received, as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse. In case shall such interest included in the gross estate of the decedent be less than the value of such part of the community property as was subject to the decedent's power of testamentary disposition."

"(4) **Community property.**—For the purposes of this subsection, premiums or other consideration paid with property held as community property by the insured and surviving spouse under the law of any State, Territory, or possession of the United States, or any foreign country, shall be considered to have been paid by the insured, except such part thereof as may be shown to have been received as compensation for personal services actually rendered by the surviving spouse or derived originally from such compensation or from separate property of the surviving spouse; and the term 'incidents of ownership' includes incidents of ownership possessed by the decedent at his death as manager of the community."

"(d) **Community property.**—All gifts of property held as community property under the law of any State, Territory, or possession of the United States, or any foreign country shall be considered to be the gifts of the husband, except that gifts of such property as may be shown to have been received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from separate property of the wife shall be considered to be gifts of the wife."

The above 1942 amendments disregard the fact that a husband and wife own a half each of the community partnership property as tenants-in-common and bring the entire community partnership property into the taxable estate of the spouse who happens to be the first to die except (1) property received as compensation for personal service actually received by the surviving spouse, and (2) property derived originally from separate property of the surviving spouse. It is important to note, however, that the minimum taxable estate, in any case, is the value of the community property subject to a decedent's power of testamentary disposition or, in other words, the undivided one-half of the community partnership property owned by the decedent and by the State law.

SOURCES OF COMMUNITY PARTNERSHIP PROPERTY

In Louisiana, insofar as the community partnership property is concerned, when either spouse dies, the estate of the decedent consists of only one-half of the community partnership property. The other half belongs and has always been owned by the surviving spouse. The undivided one-half of the community partnership property is all that the decedent could dispose of or that his or her heir or legatees could receive, because this is all that the deceased spouse owned under the local Louisiana law and hence all that he or she could dispose of.

Prior to the estate tax amendment in the Revenue Act of 1942, the estate tax was applied to community partnership property in the same way that it was to all other property: The tax was measured by the value of the property which passed by reason of the death of the decedent. In no case was the tax measured by property which the decedent did not own at death, and which the decedent had never owned. Under the prior law, since each spouse in a community partnership property State owns one-half of the community partnership estate, and the survivor's one-half is not derived from and had never been owned by the decedent, the Federal estate tax imposed upon the estate of the first to die, whether husband or wife, was measured by the value of decedent's one-half of the community partnership estate. Upon the survivor's death, the survivor's half of the property was similarly taxed. Thus the property interest of each spouse in the community was taxed on the same basis as the property of any other decedent in any other State (T. D. 2459, T. D. 3138, T. D. 3670).

THE 1942 AMENDMENTS

The Revenue Act of 1942 attempts to establish a new and revolutionary method of taxing community partnership property at death. The act abandons, as to community partnership property, and as to community partnership property alone, the test of ownership at death, as the controlling factor in measuring the tax. It purports to substitute therefor, as to community partnership property, and as to community partnership property alone, varying uncertain capricious arbitrary, and confiscatory tests, some applicable in one case, some in another.

Section 402 (b) (2) requires that the entire interest of both spouses in all community partnership property be included in the gross estate of the first spouse to die, with two exceptions only: (1) property received as or derived from compensation for personal services actually rendered by the surviving spouse; and (2) property derived originally from the separate property of the surviving spouse. Even as to these items of the community partnership property, a minimum of one-half must be included in the decedent's estate, because of his or her power of testamentary disposition over one-half of all community partnership property.

In the teeth of the State law providing for the equality of ownership of the spouses in community partnership earnings and acquisitions, the statute by pure legislative fiat arbitrarily creates three categories of community partnership property for Federal estate-tax purposes.

(1) The first category includes community partnership properties traceable to the husband's earnings or to income from his separate property. If the husband dies first, all of such community partnership properties must be included in his estate, but if the wife should die first, one-half of these properties is includible in her estate.

(2) The second category includes community properties directly traceable to the wife's separate earnings or to income from separate property. If she dies first, all of such community partnership properties fall into her taxable estate; but if her husband predeceases her, one-half of such properties is included in and taxed to his estate.

(3) The third and most important category, since it usually comprehends the bulk of community partnership property, consists of all properties not directly traceable to the earnings or income from the separate property of either spouse. As to the community property falling into this category, the full value is included in the estate of the first spouse to die. If the husband dies first, both halves are included in his gross estate; if the wife dies first, both halves are included in her gross estate.

It is to be noted, in the first place, that in the creation of the three categories of community partnership property we have described the amendment abandons and disregards the established rules of estate taxation and arbitrarily disregards

the right of each State to determine the ownership of property. It abrogates the local law, and by legislative fiat sets up at least three and, according to the Government's contention, four different rules of taxation to be applied, depending upon the circumstances of the particular case.

1. The statute selects ownership or the power of testamentary disposition as the taxable event in certain cases. We may term this the "minimum rule" of taxation under the statute. A decedent, husband or wife, is always taxed under the statute on all property which he or she owned, that is to say, over which he or she had a testamentary power of disposition. But ownership is not made the sole criterion or test of taxation, except when it is profitable to the Government to apply it. A decedent in Louisiana, more often than not, under this statute will be taxed on property which he or she did not own and over which he or she had no power of testamentary disposition. For example, the surviving husband or wife does not own, and has no power of testamentary disposition over, the one-half share of the community property traceable to the decedent's separate earnings or separate property, and yet the decedent's estate is taxable on this property, although he or she did not own half of it and did not have the testamentary disposition of half of it. This is so because both earnings of each spouse and income from separate property are—except in rare and special instances—community-partnership property. As such, the power of testamentary disposition is, of course, limited as to each spouse to an undivided one-half. And yet the decedent's estate is taxable, not for the part owned nor yet for that part testamentarily disposable, but for the whole. Moreover, where the community property was accumulated by husband and wife in a joint enterprise operating a farm or a husband and wife operating a store or other business, or where the community property was accumulated as a result of borrowing money, that is, incurring a community debt, the community-partnership property is not traceable to or derived from the "personal services" or the separate property of either spouse, and yet all of this property is taxed in the estate of the decedent, husband or wife, depending upon the accident of whichever one dies first.

2. The committee's report indicates that the theory of the statute is to tax the spouse who created the estate, or, as it states, to tax the spouse to whom the property is "economically attributable." The so-called principle of economic attribution is impracticable, unscientific, and unsound. In attempting to base the 1942 Federal estate, gift, and insurance tax amendments on this novel principle, the draftsmen of the amendments undoubtedly had in mind the simple case of a man employed on a salary who would be responsible for whatever property is accumulated during the marriage. But this is the simple, and by no means usual, case. In a great many types of cases it is impossible to allocate the economic responsibility. For example, there is no way to apply the principle in the following common classes of cases:

- (1) Successful operation of a ranch or farm;
- (2) Successful operation of a store or shop;
- (3) A fortuitous gain, such as the discovery of oil or community property;
- (4) The development of a successful business started with a loan, the loan having been paid off by the profits from the business;
- (5) Profit from speculation with borrowed funds.

The principle of economic attribution in many important situations completely disregards the wife's share in helping establish a community estate. Today women own 60 percent of the wealth in this country. More often than not the wife brings into the marriage some property of her own. The income from this property is community property, and this income and the proceeds from her separate property go into the family bank account to help toward establishing an estate. Or the wife, particularly during early married life, may be employed, and her earnings, also community, help the husband in the making of their first investments. Then there is the shopkeeper and his wife, she working side by side with him in the store. Certainly she contributes something of economic worth. There is also the farmer and his wife and the rancher and his wife. Certainly the wife in all these cases, more often than not, makes substantial economic contributions toward saving, accumulating, and building an estate.

During a long married life both spouses will have made substantial contributions in one form or another. Their funds have been commingled. Investments have been made which produce income. Sales are made and the income and proceeds reinvested. No books have been kept showing their respective contributions, because no accounting between them was necessary. All was owned by them equally. Under such circumstances, it is impossible at the death of one or

the other of the spouses to take each item of community property a band at death and to say as to their property so much as it was derived originally from the wife's earnings or separate property.

The point is that once we depart from the rules of ownership of property as established by State law and undertake to substitute the nebulous concept of economic responsibility as the basis for the tax we create untold uncertainties and ambiguities resulting in hardship and inequity. Tax laws no less than criminal laws should be plain, clear, and certain. The rule of economic attribution violates this fundamental principle of sound taxation. In placing upon the executors of every decedent in every community-property State the intolerable and impossible burden of tracing every item of community property on hand at death back through all its mutations and changes over a long married life to determine its first origins and ascertain whether the husband or wife or both were economically responsible for it, and in what degree, this law is unfair and confiscatory. It produces unnecessary and expensive litigation. It is impossible fairly to administer. Ask any revenue agent charged with the duty of examining estate-tax returns in the community-property States and he will tell you the law is inequitable, produces hardship, and is incapable of fair administration.

The amendment, however, when applied does not make this second test-to tax the person to whom property is economically attributable—the sole criterion as a basis for the tax. It is only applied by the statute when it results in increasing the amount of the tax. For example, when the community-partnership property is directly traceable to the decedent's separate earnings or to his or her separate property, and he or she dies first, the whole of the community-partnership property is taxed to him or her. However, if the nonproducing spouse dies first, the test as to who created the estate or as to whom it is "economically attributable" is abandoned, because if this test and rule is consistently applied there would be no tax in the event of the prior death of the nonproducing spouse. The statute undertakes to avoid this result by providing that in such a situation, when the so-called nonproducing spouse is the decedent, the test of ownership or power of testamentary disposition shall apply and the decedent's estate shall be taxed on at least one-half of the community-partnership property. Moreover, we should point out again that if a community-partnership property is not traceable to the compensation for personal services or separate property of either spouse and consists of property derived from their joint efforts in a farming or merchandising business or from community loans, the test of taxing the decedent who created the estate is again abandoned and the tax is laid on the whole estate without regard to who produced it, who owned it, or who had the testamentary power of disposition over it.

3. The third situation in which the taxes imposed by the statute cannot be explained on either of the two theories we have just discussed, namely, either the theory of ownership or the theory of taxing the spouse who created the estate or to whom it was "economically attributable." The third situation involves community-partnership property of the category we have already described where the husband and wife, as partners, accumulate community-partnership property not for "personal services" but as a result of farming, merchandising, or any other business in which they both participate, or accumulate such property as a result of the successful investment of borrowed money, i. e., community-partnership debts. In such cases, the first spouse to die is taxed on the whole, including the survivor's one-half share, even though the decedent had no ownership over the other half or testamentary disposition over it and even though the decedent was not the creator of the estate. We are left to conjecture as to the reason or excuse for the tax in such a case. Apparently, under such circumstances each spouse is presumed, in the teeth of both the law and the facts, to own outright the entire property, and whoever dies first is taxed on all of it.

Thus, it is apparent that the statute represents a curious, inconsistent, and arbitrary intermixture of tests involving recognition of State law at times and complete disregard for State law at other times. It adopts one test for tax purposes under one set of circumstances and another test under a different set of circumstances, none of which have any rational or logical relationship or basis as an excuse for estate taxation. The law of the State is recognized in determining the minimum taxable estate by the provision requiring inclusion of all property over which decedent possessed the power of testamentary disposition. The law of the State is entirely disregarded in determining the maximum taxable estate by the provision requiring inclusion of the portion of the community-partnership property always belonging to the surviving spouse.

The effect of this statute, then, is to disregard property rights; to tax one taxpayer with respect to the property of another; to tax him on property which he never owned, which he could not give away, could not and did not transfer at death, and which he could never convert into his own separate property. It treats—that is, conclusively presumes—two separate persons as owning the same property at the same time. It makes the tax depend on the sheer accident of which of the two spouses may happen to die first.

For example, the storekeeper and his wife are both regarded as owning at the same time the entire business, including the interest of the other, and the first to die is taxed on the whole. A farmer and his wife are each considered as owning the whole of their lifetime savings, and the first to die is taxed on the whole. A man or his wife may purchase securities on credit for their common benefit and pay off the debt with the income therefrom; yet each is considered as owning the whole, and the first to die is taxed on the whole. In fact, the bulk of all property in the community property States will be taxed to the first spouse to die, because most community partnership property is not derived from compensation for "personal services" or separate property of either spouse, and that which is so derived usually cannot be traced to such source.

The community-property amendment, if not repealed, will completely confiscate many estates and frequently will deprive a man, after a lifetime of labor, of the right or opportunity to leave anything whatsoever to his children or legatees. This can result when there is no State rule for apportionment, because there is no Federal statutory provision authorizing the decedent's executors to surcharge the surviving spouse's share of the property with any portion of the decedent's tax, comparable to the specific provision (sec. 826 (c)), Internal Revenue Code, authorizing the executors to collect from insurance beneficiaries.

For example, if a spouse dies possessed of a one-half interest in a net community estate of \$6,000,000 in value, and there are no deductions which can be proved as traceable to separate services or property, the estate tax collectible for his one-half interest, but measured by the whole, would be \$3,138,200, or \$188,200 more than his entire estate of \$3,000,000. This would mean that the husband or wife, as the case may be, would have nothing whatever to leave to their children or legatees. This would result in the absence of a State rule of apportionment, because the revenue act, although imposing a lien on the survivor's half of the community for the payment of the tax and making the survivor personally liable (sec. 411 (b), Internal Revenue Code, app., p. 6), also gives the survivor a right of reimbursement for any taxes collected for the payment of the decedent's tax (see. 826 (b), Internal Revenue Code, app., p. 10). Even if the provision of the Revenue Act could be construed as requiring a proportionate contribution between the decedent's estate and the survivor's estate for the payment of the tax, the effect of the community-property amendment would be to impose upon the decedent an unfair and much heavier tax and penalty because of the adding of the survivor's share to the decedent's share of the community. In calculating the tax, on account of the graduated estate-tax rates. For example, even if the estate tax laws could be so construed as to make each spouse pay a proportionate share, in the example we have given of a \$6,000,000 estate, the total tax of \$3,138,200 would be divided between the decedent's estate and the survivor's estate, and each would pay \$1,569,100. If only the \$3,000,000 estate of the decedent were subject to the estate tax and the \$3,000,000 belonging to the survivor was not added to measure the tax, the tax would be \$1,263,200, or approximately \$300,000 less. In other words, \$300,000 would be an arbitrary penalty imposed on the decedent by reason of including property belonging to the survivor in calculating the decedent's tax.

If community property is given away, the husband may be treated as the owner of the property and may be required to pay a gift tax on the whole community, even though the gift to the extent of one-half be to the wife of her own property, and even though, shortly before, she may have paid income taxes on the same property. Thus, the husband may be regarded as the owner and required to pay a gift tax if a gift is made during his lifetime (sec. 453); yet, if no gift is made and the wife dies, she is regarded as the owner, and her estate must pay estate taxes on the same property, always on one-half and more often than not on the whole (sec. 402 (b) (2)). The arbitrary Federal presumption created by this statute in contradiction of the State law determining ownership, and also the difficulty, and in most cases the impossibility, of doing the tracing which the act purports to permit will, as a general rule, accomplish this unlawful and unjust result.

In line with the policy of the Treasury Department ignoring the local community partnership law, the regulations interpreting the 1942 community property estate and gift tax amendments provide that in the event of a dissolution of the community partnership by the husband and wife a gift tax must be paid by the husband on the one-half of the property delivered to the wife in connection with the liquidation of the community partnership, although it is her property under the local law, because the statute conclusively presumes that the property received by the wife is the property of the husband unless shown to have been received as compensation for personal services by the wife or derived from her separate property. The interpretation of the 1942 community property gift tax amendment is announced in regulation 108, section 80.2, of the Federal Gift Tax Act which provides:

the rule * * * applies alike to a transfer by way of gift of community property to a third party, or third parties, to a division of such community property between husband and wife into the separate property of each, and to a transfer by the husband and wife of any part of such community property into the separate property of either of the husband or of the wife. * * *

It follows from the above ruling that a gift tax will be imposed if the community partnership is dissolved by voluntary agreement as is permitted in the State of Washington.

When life insurance forms all or part of the taxable estate, there is a veritable maze of confiscatory and capricious treatment under both the gift and estate tax laws. Laws of property and laws of insurance are utterly disregarded, and a self-contradictory theory of dual ownership is applied.

If, for example, the wife owns as her separate property a policy of life insurance on her husband's life and premiums are paid thereon out of partnership community funds, the husband must pay gift taxes on the entire amount of premium payments, since community funds are used to enhance the value of the separately owned property, even though the gift is, as to one-half, a gift to the wife of her own funds, and even though she may have paid an income tax on the same funds a few days previously. Yet, after having made the gift, the husband's estate, at his death, must pay an estate tax on the full proceeds of the policy owned by the wife and paid for in half by the wife's funds, on which the husband has paid gift taxes. Previously, insurance proceeds were included only to the extent that the decedent paid premiums on the policy, so that, in the community partnership property States, only one-half of the insurance was taxable where the premiums were paid with community partnership funds. (*Lang v. Commissioner*, 304 U. S. 284; *Howard v. United States*, 125 Fed. (2d) 986). But under section 404 of the 1942 act, premiums paid with community partnership funds are considered to have been paid by the insured, unless, again, such funds are traceable to the compensation for personal services or separate property of the survivor. Similarly, if a husband in a community partnership State takes out a policy on his wife's life in his own favor and pays the premiums from community partnership funds, her estate must pay tax upon the full policy proceeds, even though the policy is owned by the husband and he pays for half of the cost.

Where the community partnership is dissolved by a separation of property under the Louisiana law, without a divorce, for mismanagement, or where the marriage is dissolved by divorce, the tax is levied as it would have been prior to the 1942 amendment. If death occurs one moment after separation or divorce, only one-half of the property is taxed to the decedent. If death occurs one moment prior to separation or divorce, the whole may be taxed to the first to die. Section 402 (b) (2) applies only to property held as "community property." After separation or divorce, even if there is no partition in kind, the property is held as tenants in common and not as community partnership property. This is, perhaps, the first time in history that a statute encouraging divorce or separation of partnership property has been passed.

Where the spouses move to a non-community-property State, and there invest the community partnership property brought with them, the law, upon the death of either, will regard the first to die as a tenant in common owning only one-half of the property and limit the tax accordingly; whereas if they remain in the community partnership property State, the whole will generally be taxed to the first to die. Thus one rule of taxation is applied in community partnership property States and another rule, respecting the same spouses and the same property, is applied in the other States.

For example, the law of a new domicile will not apply the community partnership system as to property acquired after change of domicile, but it will recognize that the property previously acquired in Louisiana, or some other community

partnership property State, is owned one-half by each spouse, as tenants in common, and the wife will be recognized as owner of one-half of tile community partnership property and properly acquired with the proceeds of community property (*Depas v. Mayo*, 11 Mo. 314; *Phillips v. Commissioner*, 9 B. T. A. 153; *Gucciston of Popp*, 146 La. 404, 83 South 705; Solicitor's Opinion 121, Internal Revenue Bulletin, December 1921, p. 107; statement, Conflict of Laws, secs. 292 and 293; Beale, "Conflict of Laws," sec. 292.1). Accordingly, by the amendments of 1942 Congress arbitrarily disregards the ownership of property for estate and gift-tax purposes in only the community partnership States, in the very teeth of the law of the States involved, while if the same property is removed to the other States of the Union, the latter States recognize tile law of Louisiana and the property rights of the spouses; and Congress, following the law of the common-law States, taxes the former community partnership husband and wife on the very basis that they would and should have been taxed on if tile community property estate-tax amendment had not been adopted. In short, Congress continues to recognize for estate-tax purposes the law of common-law States which recognize in common-law terminology the law of Louisiana; but when dealing directly with Louisiana citizens and the same property, tile Louisiana property law will be disregarded.

The preceding summary and analysis of the 1942 amendments demonstrate that they establish several novel and wholly inconsistent, arbitrary, and confiscatory tests of taxation, apparently depending upon which test and which set of circumstances produces the largest tax for the Government. These inconsistent and capricious tests are applied only in the community partnership States. The statute not only measures one person's tax by another's property, it treats two persons as owning at tile same time the same property; it completely disregards State rules of property and applies one rule of taxation when one spouse dies and another rule when the other dies. It makes the incidence of tile tax depend on the sheer accident of which of tile two spouse should happen to die first; it creates double taxation and will confiscate tile estates.

Moreover, the 1942 community-property amendment undertakes to ascribe significance to tile origin of wealth without any regard to tile ownership of property either at origin or at death. It undertakes to tax an individual merely because his action may have in fact given rise to that wealth and also cases where it did not give rise to it, although at the time of its acquisitions he did not own the property and, at the time of his death, he possessed no economic interest therein. Indeed, tile statute contains all the pernicious elements of a retroactive law. For the first time it undertakes to make the estate tax depend on the source of funds used in acquiring property many years prior to death. It imposes upon spouses in the community-partnership-property States the impossible burden of tracing back through the many transactions of a long lifetime the origin of each item of property or land at death. Unless this origin is traced into the separate earnings or the separate property of the survivor, tile estate of the decedent must pay the tax on the whole. Even if a successful tracing to the survivor could be accomplished, the decedent's estate must, nevertheless, pay the tax on half. Never before has it been intimated that husband and wife must between themselves maintain accurate records of their individual transactions. This statute then takes them entirely by surprise and by reaching back and attaching tax significance to methods by which property was acquired many years prior to death, it contains all of tile unjust elements of a retroactive tax.

INSTEAD OF PRODUCING UNIFORMITY, THE 1942 AMENDMENT IS UNFAIR AND GROSSLY DISCRIMINATES AGAINST THE COMMUNITY-PARTNERSHIP STATES

The 1942 amendment, by its terms, is addressed only to community-partnership property held under the law of the community-partnership States. It has no operative effect in the other States. It is apparent from the analysis that we have given that the plan or method laid down for community-partnership States is not the same as the plan or method prescribed for the rest of the Union. It is likewise apparent from the express terms of the statute that the subject of the tax is different in these States from the subject of tax in tile other States of the Union.

(a) In all other States the general plan of taxation is to tax the transfer of the decedent's interest in the property—that is, his ownership thereof at death. In the community-partnership-property States, ownership of property is entirely disregarded, and the decedent is taxed, with respect to property which he never owned and which he could not transfer at death.

(b) It is only in the community-partnership-property States that significance is given to the origin of the property. In the other States, the fact that a decedent created wealth is not made the occasion for a tax if he did not own the property at his death (appendix 1). But in the community-partnership-property States, the mere fact that the joint efforts of the spouses created the wealth is alone sufficient to tax the spouse first dying on the entire property even though at such spouse's death he or she owned only half thereof.

(c) It is only in the community-partnership-property States that a presumption is adopted to the effect that a man and wife shall both be deemed at one and the same time to be the owner of all of the same property (i. e., that each is presumed to be the owner of the other's property), and that each is taxed on the other's property, and the tax made to depend on the sheer accident of which spouse may happen to die first.

(d) It is only in the community-partnership-property States that a bare cessation of management over property administered for another is apparently made the occasion for the imposition of the tax. In other States, the death of a partner, though he be the managing partner, does not result in the inclusion of his surviving partner's interest in his taxable estate. In the other States, the death of a trustee does not result in an estate tax on such trustee's estate measured by the beneficiary's property. But as to the community-partnership-property States, the statute provides that the managing partner of the community-partnership may be taxed on the survivor's share, and the husband, as fiduciary, may be taxed at death on property merely managed by him for his wife.

(e) Not only is uniformity denied because property rights in the surviving spouse are subjected to the tax, while essentially identical rights in the surviving spouse in non-community-property States go free; it is even more flagrantly denied in the respect that while denying reality to the wife's rights in those cases where conceding their substantiality would result in exemption, the statute conceded their substantiality where the concession results in additional taxation.

Thus, if the husband should die first, the full community-partnership estate is, more often than not, made the measure of the tax, thereby disregarding entirely the wife's half interest in such property. But, where the wife dies first, at least her half interest, being the property of which she has the testamentary disposition, is subject to the tax. Thus the statute attaches consequence to ownership only when the concession results in increased taxation, but denies it in the converse case. In no other case, and in no other part of the Union, save in the community-partnership-property States, does the law concede or deny the existence of property rights solely for the reason that concession or denial enriches the Treasury in the particular case. In capriciously denying, or capriciously insisting upon the reality of the wife's interest according to the effect upon the revenue, the 1942 act departs from the principle of uniformity, since the locale to which these discriminations are limited is the community-partnership-property States, and there are no comparable provisions applicable elsewhere. Consider against the case of domiciliaries of Louisiana moving to a common law State. (See pp. 14-15, supra.) That State will recognize the common ownership of their property, although their property is no longer community property. At death they will each be taxed on his or her half only, whereas, if they remained in Louisiana, the whole would have been taxed to the first to die. A different rule of taxation is prescribed, therefore, with respect to the same persons and the same property merely because of the locale.

Consider another example, an actual case arising since the act of 1942 where the wife died first and all of the community was included by the taxing officers as a part of her gross estate, and a deficiency demanded on that account from her executor. These spouses, soon after marriage, purchased on credit a tract of land. This land immediately became community-partnership property. They farmed it, each actually doing physical labor in planting and harvesting crops. They prospered, paid for the land, bought other lands, and ultimately accumulated a substantial estate, without either ever having at any time any separate property, and without either having received anything whatsoever as compensation for personal services; but each having made a substantial contribution in direct labor to the acquisition of each community asset. When the wife died, all property was taxed as a part of her gross estate; when the husband dies, one-half of the same property will again be taxed as a part of his estate.

To determine the geographic uniformity of this tax, contrast this tax with the tax which would have been levied had these spouses resided in a non-community-property State and had they taken title to the properties acquired as tenants in common, or as partners. In neither case would the estate of the spouse first to die have been required to pay a tax measured by more than one-half of the jointly owned property.

The vices of the 1942 amendments may be further emphasized by selecting and giving one or two practical mathematical examples, from a multitude, which could be given, illustrating the variety of gross discriminations which are involved in the application of these indefensible amendments.

Mr. and Mrs. Thomas and Mr. and Mrs. Adams live in Texarkana, Texas on the Texas side of the street in a community-property State and Adams on the other side of the street in Arkansas, a common-law State. Thomas and Adams each buys 100 shares of stock in the X Oil Exploration Co., and each gives his note for \$10,000 for the stock. The 100 shares of stock of Thomas in Texas are community-partnership assets; the note is a community-partnership debt. The asset in the form of stock does not represent compensation for personal services, actually rendered by Thomas, nor is it derived from his separate property. The 100 shares of stock purchased by Adams, of Arkansas, belong entirely to him. His wife has no interest in them whatever. Adams' note for \$10,000 is his separate debt. Dividends subsequently declared by the corporation, are applied to the full payment of the two notes. The dividends received by Thomas and applied on his note are community-partnership property. The dividends received by Adams and applied on his note are his separate property. A large oil field is discovered and developed by the X Oil Exploration Co. Thomas' stock has a market value of \$6,000,000, and Adams' stock has a market value of \$6,000,000. The wife of Thomas, of Texas, and the wife of Adams, of Arkansas, die on the same date. Thomas' wife's estate in Texas consists of her one-half partnership interest in the \$6,000,000 worth of stock, or \$3,000,000. She wills \$3,000,000 to her mother. The other one-half of the community partnership property belongs to Mr. Thomas and is not a part of the estate of Mrs. Thomas. It has always belonged to the husband. The tax on the \$3,000,000 estate of Mrs. Thomas, measured by all of the community partnership property, amounting to \$6,000,000, is \$3,138,000, or \$138,000 more than the entire value of the estate of Mrs. Thomas. All of Mrs. Thomas' estate is consumed in the payment of the tax, and nothing is left to go to her heirs or legatees.

In the case of Mrs. Adams, in Arkansas, she would have no estate under such circumstances, and there would be no estate tax. All of the \$6,000,000 of stock belongs to the husband, in a common-law State like Arkansas, and would remain the property of the husband, free of any estate tax.

Although the example we have given involves the complete confiscation of the wife's estate in Texas and no tax in Arkansas, similar examples of smaller estates not involving complete confiscation could be given, which result in partial confiscation. In every case, with exactly the same facts and circumstances involved, we have the same indefensible discrimination which results from the operation of the 1942 amendments, because of their failure to recognize the difference between the laws of the community-partnership and common-law States.

Let us consider one more example. Thomas and his wife, of Texas, and Adams and his wife, of Arkansas, living in Texarkana, accumulate an estate of \$1,000,000 instead of \$6,000,000.

Mrs. Adams, of Arkansas, dies; there is no estate tax. Mr. Adams, of Arkansas, dies later and there is an estate tax of \$325,000. Mrs. Thomas, of Texas, dies; there is an estate tax of \$325,700. Mr. Thomas, of Texas, later dies; there is an additional tax of \$140,000. The Thomases, therefore, in the community-property State of Texas, will, under exactly the same facts and circumstances pay an additional \$140,000, which is nearly 50 percent more in estate taxes, than the Adamases in the non-community-partnership State of Arkansas. The two examples given above are typical. If the length of this discussion did not have to be limited, examples could be multiplied, vividly illustrating the variety of discrimination and confiscation which is involved under different facts and applications of the 1942 amendments. Without giving practical mathematical examples, we have heretofore attempted to summarize in detail the multitude of other inconsistencies and discriminations involved in the application of the 1942 amendments.

THE FALLACY OF THE CONTENTION OF THE TREASURY DEPARTMENT THAT THE 1942 AMENDMENT WOULD TEND TO BRING ABOUT UNIFORMITY IN ESTATE TAXATION

The report of the Ways and Means Committee in 1942 states that, in adopting the 1942 amendments to the estate tax law, the Congress was attempting to remove what it deemed to be an undue advantage enjoyed by residents of community-partnership States. If it was the Congress' aim to place the community-property States on an equality with the common-law States, the statute requires

tion is wide of the mark. Far from equalizing the tax, Congress has, unintentionally and without knowing the facts, seriously discriminated against the community-property States as we have shown and has made the burden of estate taxes heavier in those State than in other States. For example, a man in New York accumulates during marriage a net estate of \$1,000,000, and dies leaving a typical will whereby his wife receives the income from his estate for her life with remainder to his children. His estate tax is \$325,700. At his wife's later death, her life estate terminates and no tax is payable when the property passes to the children. Contrast this with the Louisiana citizen who accumulates the same amount and dies leaving the same will. Under the 1942 amendment he will pay the same tax at his death as the citizen of New York, but since his will passes only his half interest, his wife at her later death must pay an estate tax on her half which amounts to approximately \$140,000. Those two spouses in Louisiana pay together \$465,000 or nearly 50 percent more than the New York spouses pay. Similarly, if in the same illustration, the wife of the New Yorker died first there would be no tax but her husband would pay \$325,700 at his later death. If the Louisiana wife died she would pay \$325,700 as against zero for the New York wife, and her husband must pay an additional \$140,000 at his later death. Again they pay nearly 50 percent more than the New York couple.

In any event, with deference, we submit that the committee seemed to be unaware of the real nature of the community partnership and substantially similar legal relationships in other States. An advantage for tax purposes presupposes that certain individuals or legal relationships are selected and given more favorable treatment than that accorded substantially identical relationships or individuals similarly situated. It is not discrimination to tax one more than another if one actually owns more than the other. Husbands and wives in the community-partnership States whom the local law makes partners are not in the same situation with regard to property rights as husbands and wives generally in other States who are not partners. The fundamental and practical features of the community-partnership law show clearly that the community partnership between husband and wife is in no sense a theory, but is in substance a partnership imposed by law which is unknown in the case of property rights of husbands and wives in common-law States. This partnership imposed by the Louisiana statutes creates burdens and limitations, as well as privileges in relation to property rights of husbands and wives. The limitations upon the husband's property rights and the rights given to wives in community-partnership States constitute practical disabilities and disadvantages which are unknown in common-law States, so far as husbands and wives are concerned, and these practical burdens outweigh any so-called tax advantage.

The real test of discrimination is a comparison between how marital partners are taxed in community-property-partnership States and how special or limited partners are taxed in other States. When this test is applied, it clearly appears that the 1942 amendments did not remove but actually created, discrimination based only on geographic location.

Since the law of each State must determine questions of ownership, it is apparent that it is not possible to obtain identical practical results from the operation of the Federal revenue laws in each of the 48 States of the Union, unless Congress wishes to do violence to the dual character of our Government and the historic and settled principle that the Federal Government must recognize marital rights and the ownership of property as defined and created by local State laws in the various States.

It is the peculiar and special province of the States to enact legislation which will make for stability of the family and encourage family life. In the exercise of this province certain of the States, long before the adoption of any Federal income or estate tax laws, have seen fit through community partnership laws, as Louisiana has always done since the first European set foot on her soil to invest husbands and wives with a community or partnership of interest in the business and financial transactions of each other, as well as in their social and personal relationships. This constitutes a valuable advance in the recognition of women's rights and in social progress. It gives, particularly to the wife, a position of security and a just, direct, and vested ownership in the financial gains resulting from the endeavors of her husband and herself. It invests the wife with the status of equality; and emancipates her from the limitations and status of inferiority to which she was subjected under the ancient common-law principles. It enables the wife to maintain her self-respect as a human being with equality with her husband and thus eliminates the irritation which otherwise may arise between those essentially equal but occupying positions of dominance or subservance.

The community partnership property system ministers to the success of family life. It is only natural that a wife who has a vested community ownership in the earnings of her husband may be expected to take a greater interest and cooperate with more enthusiasm in the activities in which her husband is engaged than will a wife who is by law made inferior and dependent upon her husband's generosity. Moreover the wife, whether she serves in the homes or in her husband's business, or both, is in fairness entitled to equal treatment and equal property rights. These are the concepts which underlie the community property system.

The policies of the various States which have adopted the community partnership system involving the recognition of these progressive concepts and the attempt to establish a better plan of marital relations in their respective States are justly deserving of encouragement and support. At least such States should not be thwarted or embarrassed in the adoption and administration of such policies by any legislation of the Federal Government, which will render less effective the community property partnership system, or deny to the members of the marital partnership the full benefits and enjoyment of the rights thus established.

It is of the utmost importance that Federal legislation shall not trench upon this critically important field of State action or impede the States in the pursuit of this evolution in social progress. The fundamental importance of the family as the basic unit of the social structure of our Nation has long been recognized and clearly established. It certainly should not be within the authority of the Federal Government to adopt or enforce legislation which will discourage or indirectly annul or invalidate in any manner whatsoever the legal effect of statutes of the States serving the purpose of social advancement in connection with a question of such vital domestic importance.

The Treasury Department, which sponsored the estate-tax amendment, seems to feel that uniformity is desirable. It is obvious that mathematical uniformity cannot be obtained by having Congress, in the form of a discriminatory legislative act, disregard the fundamental laws of some States of the Union and at the same time recognize the local law of all of the other States of the Union as a guide and basis for the application of the Federal estate-tax law. If the Government desires to tax the separately owned property and estates of both husband and wife, as a whole and as a unit, it is not fair to attempt to bring about this result by legislative fiat in only a few selected States of the Union.

If mathematical uniformity is sought to be accomplished, Congress should adopt income, estate, and gift-tax equalization provisions of the pending bill sponsored by the American Bar Association, which place husbands and wives in common-law and community-property States on substantially an equal mathematical basis with regard to income, estate, and gift taxes. The pending bill now being considered by your committee contains these provisions which will accomplish mathematical uniformity by exempting one-half of the decedent spouse's property passing outright to the surviving spouse whether by will, intestacy, or otherwise. This exemption does not apply to the decedent's interest in community property, with the result that common-law and community-property States are given substantially the same uniform mathematical treatment for estate- and gift-tax purposes.

As a matter of equity and practical effect, the pending income, estate, and gift-tax equalization provisions mean that spouses in common-law States will not have to give to each other any ownership whatever in marital property which they acquire, but will nevertheless enjoy in the future the same privileges of dividing their income, estate, and gifts for tax purposes as spouses in community-property States, where the wife admittedly has a real and substantial one-half ownership of the property. Community-property States, in accepting this provision of the equalization bill, justifiably feel that common-law States in the future will have a preferred position not only with regard to income taxes but as to estate and gift taxes as well. This will result because the fight to a 50 percent exemption in the case of income, estate, and gift taxes for married taxpayers in the common-law States will be given without regard to ownership of property, whereas, in the community-property States the admittedly real and substantial ownership of the wife will not be given the preferred recognition in our tax system to which it is entitled and which has been enjoyed in the past.

The equalization plan set forth in the pending bill at least does not disregard the property rights of community-property States. For that reason, alone, these provisions offer a new and fairer solution of the problem of uniformity. Louisiana community-property taxpayers feel that the 27-year-old community-property

controversy should be finally settled. The practical solution and settlement of difficult problems of this kind inevitably involve mutual concessions and compromise. Louisiana taxpayers are, therefore, in favor of and are supporting the income, estate, and gift-tax equalization provisions of the pending bill because we believe that these provisions contain and represent the fairest and most practical mathematical solution of a very difficult and confusing Nation-wide problem and controversy.

The pending bill also contains provisions for the repeal of the 1942 amendments. Regardless of whether the universal equalization plan, in whole or in part, becomes law, we submit that we have demonstrated that the inequitable and discriminatory 1942 community-property amendments should be repealed—and repealed retroactively.

Respectfully submitted.

CHARLES E. DUNBAR, JR.,
JOHN M. WISDOM,

Attorneys for the Louisiana Community Property Taxpayers Committee.

APPENDIX

The only exceptions to the plan of limiting the tax to property beneficially owned at death by the decedent are (1) transfers in contemplation of or intended to take effect in possession or enjoyment at or after death, including transfer where possession, use, enjoyment or income is reserved for the decedent's lifetime (sec. 811 (c)); (2) transfers where the decedent reserved power to amend or revoke a gift (sec. 811 (d)); (3) transfers by decedent to his wife or a third party of an estate by the entirety or joint tenancy (sec. 811 (c)). In each case the inter vivos transfer is specifically includible only if the decedent originally owned the property and he made or caused the transfer to be made donatively and without consideration.

And, in each case, the inter vivos transfer must be donative or testamentary in character (e. g., transfers in contemplation or to take effect at death) or such as would not serve finally to vest the property in possession or enjoyment until the transferor's death (e. g., joint estates with survivorship, revocable trusts). In each instance a specific statutory provision was enacted to prevent tax avoidance. These serve to emphasize the basic character of the tax as an excise on the privilege of passing property at death.

In the *Estate of Rogers v. Helvering* (320 U. S. 410, 413), Mr. Justice Frankfurter, speaking for the majority of the Court, said: "For the purpose of ascertaining the corpus on which an estate tax is to be assessed, what is decisive is what values were included in dispositions made by a decedent, values which but for such dispositions could not have existed."

The CHAIRMAN. You may proceed.

Mr. DUNBAR. At this juncture, since my colleagues have covered so many phases of the 1942 amendments as a result of questions by the committee, I think in fairness to the committee I will not go over this ground again. Instead of making a rather lengthy presentation, I am going to simply summarize our objections to the amendments in a very brief and sketchy way in the light of the complete arguments in my printed statement.

The objections to the 1942 amendment which I will attempt to summarize will fit in with and explain all of the illustrations given by my colleagues and those contained in my written statement. You will understand and from this analysis, I think why all of the confiscation and partial confiscation results.

These amendments, Mr. Chairman, as Mr. Jackson has told you, in fairness to the Ways and Means Committee, were sponsored by the Treasury Department in 1942 and adopted in executive session in a war-emergency bill without our having an opportunity to be heard. The community-property law is confusing, and we realize probably that a misunderstanding of that law brought about many of the inconsistencies and inequities. I will attempt to summarize.

A simple reading of the 1942 amendments demonstrate that they establish three different and inconsistent tests and rules of taxation, disregarding State law and arbitrarily defining community property and rules and principles of taxation. The particular rule is applied and the factual test in each case that will produce the largest tax for the Government. ••

The minimum rule the amendments establish is the ownership rule, taxing the person who owns the property. That is done by taxing the person who has the testamentary disposition of the property. But that rule is only applied by the statute when it results in the largest tax to the Government. It is not followed when the decedent involved does not own the property. For instance, a spouse who produces the community property, but owns only one-half of the community estate, is taxed on all of the property when he or she dies. If the man is a professional man, or the wife an actress, the rule of ownership is departed from in such cases because only one-half would be taxed if the statute followed the rule of ownership. The rule of "economic attribution" is applied and the whole estate is taxed in such cases evidently because it produces the largest tax.

There is a third category of property and test of taxation that I will speak of in a moment that is not explainable under either the theory of ownership or economic attribution.

The second theory of the statute or test-and it sounds very plausible-is to tax the person to whom the property is economically attributable. But this rule is applied only where application of the rule results in the largest tax. If the husband is the producer of the community estate, all of it is taxed both his half and the wife's half when he dies. If the wife is the producer through her own earnings, or otherwise, all of it is taxed. But if the nonproducing spouse happens to die first, logically you would think there would be no tax at all under this theory. If you are taxing the person to whom the property is economically attributable no tax should be due when the nonproducing spouse dies first. But the amendment abandons that theory under such circumstances and goes back and applies the ownership theory. It recognizes and applies the State law and taxes the deceased spouse on his or her half of the community partnership property. Therefore, ownership is applied where economic attribution will not work to produce a tax.

Now, there is a third category, a property and test of taxation applied by the statute which is not consistent with or explained by either of the two rules or tests I have described.

Mr. Jackson referred to it very briefly. This type of community partnership property makes up a large part of the community property in estates. For example, a husband and wife run a store together or a business. They do not pay each other salaries. It is a joint venture. It might have been a partnership arrangement in a common-law State and, of course, the property accumulated is community property. Or they could buy a farm or a plantation on credit which would be a community debt and work it jointly. Oil could be discovered. All of the accumulations and profits are community-partnership property. For example, they could borrow money and invest it and make large profits on the investment. That is community-partnership property. They could speculate with borrowed money. The profits would be

community property. I could give other examples, but in the type of cases I have described the community-partnership property is not traceable to compensation for the personal services of either spouse. It is not traceable to the separate property of either spouse. It is not separately economically attributable to either spouse. The third rule is a rule of taxation applied by the amendment, but it, is not based at all on taxing the spouse to whom the property is economically attributable.

THE CHAIRMAN. Senator Overton, we are glad to have you with us. Senator Overton. Thank you.

MR. DUNBAR. The whole community partnership property—both the husband's half and the wife's half—in the type of case I have described is all taxed to the first spouse to (lie without regard to who produced it, or who owned it. Both the rule of ownership and the rule of economic attribution are abandoned. There are no deductions; in such cases the survivor can claim under the statute because this type of community property is not derived from the separate property of either spouse and is not derived from separate earnings. We are left to conjecture as to the excuse or reason for the tax in such cases. Apparently in such cases, each spouse is conclusively presumed in the teeth of both the law and the facts to own outright the entire property and whoever happens to die first is taxed on all of it.

I have developed the arbitrary and inconsistent rules and theories of the statute in detail in my printed argument. I felt, it would be helpful here to briefly summarize some of the inconsistencies in order to explain the actual illustrations given by my colleagues this morning and why grossly unjust, discriminatory, and confiscatory results have been brought about by the application of the 1942 amendments.

You will note that the statute disregards State law where disregarding State law results in more taxes. It recognizes State law where recognizing State law results in more taxes. The result of the statute in its tests and tax effect is arbitrary, capricious, inconsistent, and confiscatory.

I have given many illustrations in my printed argument of the discriminatory and confiscatory results of the 1942 amendments. Mr. Jackson gave you several illustrations this morning. I do think that the best argument in support of our objections to the 1942 amendments is that our common-law friends are unanimously in accord with us as to the discriminatory and confiscatory effect of these amendments.

We have felt in the past, rightly or wrongly, that we were entitled to our income tax rights because in the community-property States substantial ownership and property rights existed which did not exist in the common-law States. We realize, however, that mathematically we have been paying less taxes proportionately than our common-law friends and, as the chairman stated this morning, this disparity should be finally settled in a practical, mathematical way on an equal basis. Accordingly our Louisiana committee favors the American Bar Association bill as the fairest and most practical solution of the controversy—assuming, of course, in any event the 1942 amendment will be retroactively repealed.

THE CHAIRMAN. We spent today, Senator Overton, discussing community-property problems, and the witness has been discussing the

effect on estate and gift taxes of the so-called 1942 amendment, and a number of suggestions have been made that that should not only be repealed but that the benefits of repeal in the community-property State should be made retroactive.

Senator OVERTON. I coincide in that view, if I may say anything. I am glad you are here, Mr. Dunbar.

The CHAIRMAN. Your views will be very welcome.

Senator OVERTON. I consider Mr. Dunbar one of the best-posted men in the United States on that subject.

Mr. DUNBAR. I appreciate that very much and wish I deserved it.

Senator GEORGE. Mr. Dunbar, do you go into the equities of a retroactive provision in your brief?

Mr. DUNBAR. Mr. Jackson goes into that in his statement that is filed with you in greater length, but, of course, I assume that, if I have successfully demonstrated the inequity and confiscatory result of these amendments in my argument, it would follow logically from that, that we have been unfairly and improperly taxed, and inferentially the amendments should be repealed retroactively.

Senator GEORGE. I do not know, Mr. Dunbar, whether you would be altogether justified in making that assumption, because of the fact that a lot of bad taxes have been reimposed and subsequently repealed.

Mr. DUNBAR. I realize that, but we hope we can demonstrate this is among the worst. That is, of course, for you gentlemen to consider.

The CHAIRMAN. It has been suggested, Mr. Dunbar, if you repeal this retroactively that in order to establish complete equality, you should also extend benefits of the split income to common-law States retroactively.

How does that strike you?

Mr. DUNBAR. My answer to that, of course, brings up the old controversy, and I am not trying to revive it, because I know my common-law friends do not wholly agree with us. We in the community-partnership States have felt that our community partnership, which is analogous to a limited partnership in common-law States, more than anything else, has entitled us to the so-called tax benefits because of the ownership and burdens based on property rights, in the community States which do not exist in the common-law States, similar rights did not exist. Common-law States, in other words, it is not discrimination to tax me less if I own less than you do, and we have always felt we are entitled to this benefit because the ownership of property is different in common-law and community-partnership states. We have paid less taxes to the Government because of our peculiar laws. As I said, we feel, however, this equalization plan is bound to come eventually for the reasons, Mr. Chairman, you explained this morning.

On the other hand, we feel, if we are losing what we thought we were entitled to as a preferential right for the future, that the retroactive repeal is very little compensation as compared with what we think we are giving to our common-law friends, namely, the right to split estates and incomes without adopting our property rights and assuming the same burdens.

With all due deference, the common-law States never wanted to adopt the community-property system until the taxes became so high they felt maybe the assuming of our property burdens would be worth while, and I am told some of the States are still debating as to whether

they want to give their wives half of their future acquisitions in properly by adopting the community-partnership system of law in order to obtain the so-called tax benefits which result.

The CHAIRMAN. Sometimes we pass a law where the burdens are not assumed, and the law is declared unconstitutional.'

Mr. DUNBAR. I have not repeated it here, but we have demonstrated to congressional committees and the Supreme Court in the past the substantiality and reality of our laws of property. The Louisiana Community-partnership law is real and not a fiction and was not adopted to avoid taxes or see how few rights we could give the wife and still call it a community system.

We feel in supporting this equalization bill, while it ought to be worked out in the interest, as you have stated this morning, of settling a controversy and equality of taxes, we in the community-property States are being deprived of a privilege we thought we were entitled to. Although this is denied by some of our common-law friends, from our standpoint we are giving them a mathematical tax privilege and benefit which is not justified by their property laws and which is justified by their community-partnership laws.

That is one of the reasons I would give us to why we are entitled not only to repeal of the 1942 amendments, but to a retroactive repeal.

The CHAIRMAN. Senator Overton, do you wish to ask any questions? Senator OVERTON. No; I think not.

Mr. DUNBAR. Senator, I might explain to you the matter was covered so fully this morning I felt it would be unfair to the committee to repeat our arguments of this morning and have filed a more elaborate statement on the entire subject and I am now only attempting to summarize the arguments so ably presented by my colleagues.

The CHAIRMAN. Mr. Dunbar submitted a very fine and full statement which we are putting in the record in full.

Senator GEORGE. I would not be impressed, Mr. Dunbar, by the view of the common-law States that we should go back and give them some relief. While I am from a common-law State, I do not think there is any force in that observation that the common-law States should likewise be given some retroactive benefits under this bill.

I would be wholly unable to see that.

If it is simply an error in posing rather a bad law, probably sound public policy would not encourage giving retroactive benefits because you would discourage efforts to repeal if possibly, at least by those people who gather the taxes and who have to have them to run the Government.

But I never thought this was a good law. I did not think it was when it came over to this committee, and as you very properly observed, or someone else observed this morning, it came in in wartime and came in at a time also when we did not have an opportunity to go into this particular feature.

The 1942 act, if you will recall, is a rather comprehensive act, as I now recall it, and there were a lot of things in that act.

We did not have time to go into this community-property provision that was written in first in the House and then brought over here to us in the way we should have done.

I did not mean to argue against the equity of making this provision retroactive in the community-property States but I simply wondered

if you had covered in your brief what you regarded as the essential equities in making it retroactive.

Mr. DUNBAR. Senator George, I have attempted to as far as I could demonstrate that, and I would like to say this parenthetically about the 1942 situation.

As you know, the 1942 amendment was passed in executive session without a hearing, and if we had attempted to ask our Senators, or others, to fight this on the floor or anywhere, we would have asked them to do what scented to be an unpatriotic thing at that time, because the bill was so comprehensive and involved so many taxes, we would have been put in a position of allowing our selfish interests to defeat the war effort.

I think in fairness to us, it should be said that during normal times we would have been up here and asked Senator Overton and our friends to make such a fight, but under the circumstances we could not fairly do that.

Senator GEORGE. I might say, by way of exculpation for myself personally, we sometimes have people representing the Treasury up here whose philosophy I could never understand.

Mr. DUNBAR. If I may say so, I have never been able to understand the theory of that law. I can understand one theory at a time in the law but not all three of them applying at the same time.

Mr. Chairman, I appreciate the opportunity of testifying.

The CHAIRMAN. Thank you. We are glad to have you.

Mr. DUNBAR. It was only to save your time that I have not elaborated a lot of points.

The CHAIRMAN. Our next witness is Mr. Pierson.

Will you state your name and residence and occupation?

STATEMENT OF CLINT L. PIERSON, ATTORNEY, BATON ROUGE, LA.

Mr. PIERSON. Clint L. Pierson, Baton Rouge, La. I am a practicing attorney there.

I had an opportunity prior to this hearing, after I had asked an appearance here, to read Mr. Dunbar's brief, and I knew then that the subject matter was fully covered, and he gave me the benefit of his observations of the subject matter that would be covered by the preceding witnesses.

Therefore, I have decided I would only take a few moments of Your time, because it has been fully discussed, and I think discussed in a very able manner.

I do not represent any of the community-property committees. I am not associated with them other than that I think the clients I do represent do subscribe to the Louisiana community-property taxpayers' league, or an association of which Mr. Dunbar and Mr. Wisor are representatives.

The CHAIRMAN. We will be glad to have your views.

Mr. PIERSON. I am a practicing attorney of Baton Rouge La., and happen to represent two or three successions which are affected by State taxes under the provisions of the 1942 amendments, and hence my appearance here today to urge the retroactive repeal of that legislation.

Since the bill as passed by the House of Representatives repeals the 1942 amendments, the remarks to follow will be based on the assumption that those amendments will be so repealed.

It appears to me that it would be manifestly and grossly unfair and inequitable to say that a widow, whose husband happened to pass away during the 1942-48 period, should have to pay estate taxes on her portion of the community estate, while other widows, whose husbands died either before the effective (late of the 1942 amendments) or after the effective date of the repealing statute, would be absolved from the payment of said statute. Certainly they have no control over the time of death, and it would be unpardonable to so penalize those widows because they were unfortunate enough to have lost their husbands during such a short given period of time.

I would like to give the committee the benefit of a direct example of the effect of these amendments on a widow whom I represent, which I believe will show that those amendments, aided and abetted by the ruling of the Internal Revenue Commissioner, 1947, and the provisions of other sections of the revenue act that were in existence prior to the 1942 amendment, regarding income taxes, are confiscatory, to say the least.

THE AIRMAN. Is this a ruling in a case of your own or a general ruling?

MR. PIERSON. No; it is a general ruling. I think it was issued in October 1947.

I very hurriedly wrote the memorandum last night and I did not have the benefit of that ruling number.

I heard an example given here this morning by Mr. Jackson which, I think, fits the case I am about to give you as a concrete example like a glove.

This widow was the owner, under Louisiana law, of one-half of all the property belonging to the community of acquests and gains existing between her and her deceased husband.

Among other property was an item of oil royalty and carried interest in lands in Frath Field, Vermilion Parish La., which were valued at \$200,000 for the widow's one-half interest therein.

In other words, it was worth \$400,000 and her half was valued at \$200,000.

She had other property, but we attributed to this property alone under the 1942 amendments her estate-tax liability approximately \$100,000. It might have been a little under that, but we tried to break it down to see what it was.

THE CHAIRMAN. That was a logical attribution; it was not an arbitrary attribution?

MR. PIERSON. I tried to figure its worth against the whole estate, and her estate tax was \$114,000, and we attributed a little under \$100,000 to be derived from this property.

I have tried to isolate this property for purposes of illustration as to what would happen under the Commissioner's ruling.

Now, in order for her to raise the necessary funds with which to pay her estate-tax liability, it was necessary to sell these property rights, and she did so for the sum of \$200,000.

Under the ruling of the Commissioner, her income-tax liability for the year in which she disposed of that property, profit or loss, would

be based upon adjusted cost basis and not the value on which her estate-tax liability was computed, as would be the case in the instance of the heir or legatee.

The other half of the community that would actually be inherited by the children and legatees, on the other side of the picture, their basis would be the \$200,000 figure placed on this property in succession proceedings and in computation of estate taxes.

By virtue of that ruling they would have to pay for that taxable year—I do not think the return is filed yet, because the tax is due—15 for 1947—based on long-time capital gain and 25 percent imposed \$50,000 additional on that sale of \$200,000 piece of property.

This property, as I have pointed out in my written statement, was on the books of the community at practically nothing because as in the illustration, again, that Mr. Jackson gave, it arose by virtue of purchase of oil leases, taking of oil leases, and purchase of royalty in unproven fields.

And the cost basis to this widow's husband or community when he was living is practically nothing, so to speak.

Since then, it has been, since oil was discovered in there, communitized and combined with other producing royalties and major companies, the value has risen.

In other words, in that instance, it would take approximately \$150,000 of that \$200,000 of the property in order to dispose of her estate tax liability and ensuing income taxes based on the Commissioner's ruling of last fall.

By the time her returns are audited, it would not surprise me to see the Department contend that the sale was subject to an ordinary taxable gain, and then she would be in the hole on property.

The CHAIRMAN. Do you have estate tax down there, too?

Mr. PIERSON. Inheritance tax there, we call it.

The CHAIRMAN. Is it substantial?

Mr. PIERSON. Very nominal.

Gentlemen, these 1942 amendments are aimed solely at women survivors in community-property States. You will know that as a general rule the widows are least capable of earning a livelihood after the death of their spouse, and in most cases must live the remainder of their lives on the principal of their portion of the estate. They should not be put in the same category for estate-tax purposes as the children or legatees are put.

The children have a future earning capacity which the widow does not enjoy in most cases.

That is a humanitarian interest that is also involved.

I appreciate the opportunity of being able to appear here today and hope that my simple remarks will lead you to understand the inequities which would exist if you do not make this repeal retroactive.

I am confident that you would not wish to penalize the unfortunate widows who so happened to lose their mates during this short time.

The CHAIRMAN. Any questions, Senator Overton?

Senator OVERTON. No questions.

The CHAIRMAN. Thank you very much for coming.

Mr. PIERSON. Thank you.

The CHAIRMAN. Mr. Nixon is our next witness.

Will you give your name and residence and occupation to the reporter?

STATEMENT OF RUSS NIXON, WASHINGTON REPRESENTATIVE OF THE UNITED ELECTRICAL RADIO AND MACHINE WORKERS OF AMERICA, CIO, WASHINGTON, D. C.

Mr. Nixon: Thank you, Senator Millikin.

I am Russ Nixon, the Washington representative of the United Electrical, Radio and Machine Workers of America, CIO.

The CHAIRMAN. Do you have a statement that you wish to read?

Mr. Nixon. Yes, sir; I have a statement which is in the hands of the committee and the clerk, and I would like to submit that for the record, and I will summarize it extemporaneously if that is satisfactory.

The CHAIRMAN. That will be all right.

(The statement is as follows:)

STATEMENT OF INDIVIDUAL INCOME TAX REDUCTION ACT OF 1948 BY RUSS NIXON, WASHINGTON REPRESENTATIVE, UNITED ELECTRICAL, RADIO & MACHINE WORKERS OF AMERICA, CIO, SUBMITTED TO SENATE FINANCE COMMITTEE, MARCH 8, 1948

INTRODUCTION ; THE NEED FOR A SOUND ANTI-INFLATION TAX PROGRAM

Nearly a year has passed since the Congress discussed tax reduction. It has been a year of high inflation, eating away at the living standards of the American people and the stability of our economy. A year has been lost in which action might have been started to counteract these dangerous trends. It is all the more urgent that constructive measures be taken now to grant some relief from high living costs and to put consumption on a sound, long-range basis.

The recent break in commodity prices showed the unsoundness of the present economic situation. It showed that current levels of production, employment, and income are on a precarious basis. Regrettably it has been seized upon as a pretext to abandon talk of price controls, although the net effect upon living costs has been virtually zero. On the contrary, it should have served to warn the Congress that unless anti-inflation measures are speedily taken, the economy will become more and more vulnerable to severe contraction in sales, production, and employment.

A sound tax-reduction measure at this time can do much to grant relief from high-living costs and to sustain consumption. Present taxes drain off too much purchasing power from low incomes. That is the central issue in taxation today. It is the simple issue of whether you grant relief exclusively to the victims of inflation, or whether you dissipate much of the essential relief in the form of a hand-out to the beneficiaries of inflation. That is a simple issue, and the voters will judge in November how squarely you meet it.

H. R. 4790 DOES NOT PROVIDE ADEQUATE RELIEF WHERE IT IS NEEDED

H. R. 4790, the proposed Republican Revenue Act of 1948, does not meet the needs of the times. It is only a dressed-up version of H. R. 1, which twice failed of passage last year. The basic criticism which I made of H. R. 1 when I appeared before your committee last year applies to H. R. 4790. The bill provides relief in reverse ratio to the order in which the tax burden was extended in wartime. Under the misleading slogan of reducing the wartime tax burden, it leaves incomes under \$5,000 carrying the major share of the tax burden they patriotically assumed in wartime, and five times the share of the income tax they paid in 1939. When the rise in living costs since 1939 is taken into account, the group whose real income and living standards are measured by \$5,000 or less today is carrying 10 times the share of Federal income taxes paid by the group with comparable living standards in 1939.

The total Federal income-tax liability under present law, 21.3 billion dollars, is 23 times the 1939 income tax. The tax on incomes under \$5,000—\$12,000,000,000—is 132 times their 1939 tax of \$91,000,000. Under H. R. 4790, incomes under \$5,000 would still pay 80 times as much income tax as in 1939 (House report on H. R. 4790, p. 28).

Clearly, H. R. 4790 does not begin to reverse the wartime shift of the tax burden onto low incomes.

H. R. 4790 REPEALS ONLY A SMALL PART OF THE WARTIME SHIFT TO LOW INCOMES

In 1939, incomes under \$5,000 paid about 10 percent of Federal income taxes. Under present law, they pay about 50 percent. Under H. R. 4790, they would still pay nearly 50 percent (table 1).

The shift of the tax burden to low-income groups is shown more sharply if we compare comparable levels of real income and purchasing power. In 1939, an income of \$3,000 was worth as much in goods and services as an income of \$5,000 today—due to the fact that consumer prices have subsequently risen more than 70 percent. In 1939, incomes under \$3,000 paid less than 5 percent of Federal income taxes, while, under present law, incomes under \$5,000 pay more than half of Federal income taxes. (The proportion of spending units falling under \$3,000 in 1939 was about the same as the proportion falling under \$5,000 in 1947—about 90 percent.)

In 1939, there were 6.9 million persons with incomes under \$5,000 on the Federal tax rolls. Under present law, there are about 52.3 million. Under H. R. 4790, the number of taxpayers under \$5,000 is reduced to 44.0 million (table 2).

Comparing equivalent real incomes, there were 5.4 million taxpayers under \$3,000 in 1939, compared with 52,000,000 under \$5,000 today.

GREATEST TAX RELIEF GIVEN TO LOW INCOMES

The distribution of relief under H. R. 4790, though not as inequitable as that proposed under H. R. 1 last year, is still far from equitable. The 96 percent of taxpayers in the income group below \$5,000 would get about 72 percent of the total relief. Instead of 100 percent, their economic need requires. (H. R. 1 gave them 60 percent of the total cut.) The average relief per taxpayer is steeply graded in favor of high incomes, starting at \$61 for the income group under \$2,000 and rising to an average of \$4,740 for the income group over \$25,000 (table 3).

At specific income levels, the relief provided by H. R. 4790 would result in an increase in spendable income of 3 percent for a family of four at \$2,500, ranging up to 67 percent for a family of four at \$500,000 (table 4).

FOUR CENTS AN HOUR FOR WORKER—\$16.40 AN HOUR FOR CORPORATION EXECUTIVE

If we take a worker with three dependents, earning \$2,500 a year (which is close to average), the tax relief under H. R. 4790 is 4 cents an hour for a full year's work at 40 hours a week.

For an executive at \$25,000 it is \$1.60.

For an executive at \$200,000 (which is about right for the top corporations of the electrical industry) the relief amounts to \$16.40 per hour.

EXTENSION OF INCOME-SPLITTING TO ALL STATES IS STEP BACKWARD

One of the most inequitable provisions of H. R. 4790 is the proposal to extend to all common-law States the privilege of splitting family income. According to the National Industrial Conference Board study, this proposal would benefit about 5,000,000 couples in the 35 noncommunity property States. (NICB Business Record, January 1948, p. 8.) According to Secretary Snyder's testimony before the House Ways and Means Committee, income-splitting would result in a revenue loss of \$803.5 million—97.5 percent of which would go to individuals with net incomes above \$5,000. (Hearings on H. R. 4790, p. 23. In Mr. Knutson's report on H. R. 4790 the loss is calculated at \$601.2 million, but this does not substantially alter the distribution of the relief.)

Income-splitting results in no significant saving for any income below \$4,000. Even at \$4,000 the saving is only \$19; but at \$10,000 it is \$342, and at \$100,000 it is \$12,854 (table 5). In the income brackets between \$13,000 and \$100,000 the saving in 5 years is equal to a whole year's taxes.

Instead of leading the way toward further tax relief of this kind for the wealthy, Congress should require mandatory joint returns in all States. According to the NICB study, this would affect only 1.4 million couples but would increase Federal revenue by \$542,000,000. This should be applied to reducing the Federal debt or to the financing of Federal housing and other welfare programs.

H. R. 4790 WIDENS THE LOOPHOLES IN ESTATE AND GIFT TAXES

As the minority report on H. R. 4790 points out, "the proposal for splitting of income between husbands and wives has given people residing in community

property States the opening to seek repeal of the 1942 amendments (strengthening the estate and gift tax system) as the price for acceptance of equalization for income-tax purposes" (Report on H. R. 4790, p. 75).

The estate-and-gift-tax provisions of H. R. 4790 constitute a nail on the public revenues to the extent of \$250,000,000 yearly. An attempt has been made to justify the enactment of these provisions on the basis of the need to equalize the estate- and gift-tax treatment of residents of community property and common law States. As the statement of Secretary Snyder to this committee on March 1 clearly shows, the provisions of the bill completely fail to accomplish their alleged purpose. As Secretary Snyder's statement further points out, existing law produces equality. At best, therefore, the effect of the bill is to reduce taxes for certain groups under the guise of tax equalization. Although the income-tax provisions of the bill are not the equitable way to reduce taxes, they at least provide some measure of relief for low-income groups. The estate- and gift-tax provisions, however, would benefit only those with estates of \$50,000 or more, and those who make gifts exceeding \$30,000. The bill would benefit only the comparatively wealthy people. Thus, the wealthy would not only receive larger income-tax reductions than are warranted, but they would also receive substantial transfer tax benefits.

The proposed revision appears to steal from the insistence of community property States that the 1942 amendments governing the estate and gift tax treatment of community-property should be repealed. Prior to the enactment of these amendments, residents of community property States paid lower transfer taxes than residents of common-law States. Congress recognized the inequity and brought about equality by increasing the taxes payable in community property States to the level of those payable in common-law States. If the 1942 amendments are not repealed, the existing estate- and gift-tax system will remain unchanged.

Even if the Congress is convinced that some statutory changes are necessary to produce equality, it is shocking to reduce the taxes of wealthy persons by \$250,000,000 in order to do this. Any changes necessary to produce equality can and should be made within the framework of the existing system. Under existing law, the yield of the estate and gift taxes, about \$816,000,000 per annum, is grossly inadequate. The reduction in yield which would result from H. R. 4790, about one-third of the total yield, would virtually destroy the transfer tax system. The aim of Congress should be to strengthen the estate and gift taxes, not to weaken them.

It may be pointed out to those interested in reducing income taxes that they can succeed in their desires without being forced to accept the so-called wealth splitting provisions of the bill as the price to be paid for income-tax reduction. It is doubtful that any Member of Congress will or will vote against a bill which provides substantial income-tax reductions merely because the estate and gift taxes are not also reduced. Moreover if, as appears to be necessary, the over-all tax reduction must be pruned, the estate and gift tax provisions of H. R. 4790 appear to be a good place to do so.

WHAT ABOUT ENCOURAGING VENTURE CAPITAL?

I think I have presented sufficient evidence that H. R. 4790 is basically a form of camouflaged relief for the wealthy. The bill gives low incomes more relief than was provided in H. R. 1, enough to make it palatable to voters in an election year. But its chief benefits go to high incomes.

The most persistent justification for this kind of tax reduction is the argument that present tax laws stifle investment, forcing corporations to buy plant and equipment out of undistributed profits and depreciation reserves or through bank loans and bonds, rather than by selling stocks. As one NAM official put it last year, taxes "take front that group of people who were normally the chief investors of the country practically everything above their absolute living requirements," with the result that "there is practically no new capital coming into industry. Industry is living off itself, just as a camel, in periods of famine, lives off his hump" (Wilson Baden, director of NAM education and industry program, AP dispatch, Sept. 29, 1947).

I think it is important to take this argument apart, to show that it is nothing but a specious plea for further "tax relief for the greedy."

First of all, do present tax laws actually take from the investing class "practically everything above their absolute living requirements"? As the NAM admits, this class consists of income groups above \$10,000, as "relatively little" venture

capital can be tapped in smaller incomes (Earl Bunting, NAM president, quoted in New York Journal of Commerce, August 29, 1947). Taking a married couple with no dependents, here is the spendable income left after payment of present Federal income tax at various income levels (House hearings, p. 34) :

At \$10,000 spendable income is.....	\$7, 817.
At \$15,000 spendable income is.....	10, 933
At \$25,000 spendable income is.....	15, 918
At \$50,000 spendable income is.....	25, 205
At \$100,000 spendable income is.....	36, 872
At \$250,000 spendable income is.....	58, 000

For those with more dependents, of course, the spendable income would be somewhat greater.

If these figures of spendable income after Federal income taxes represent "absolute living requirements," how does the NAM explain the fact that the Bureau of Labor Statistics found it possible for a worker's family of four to maintain a "modest but adequate American standard of living" as of June 1947 on \$3,000 to \$3,500 a year? If it takes upward of \$7,800 to meet "absolute living requirements," why do the members of the NAM pay the average manufacturing worker only \$2,700 a year (at the December 1947 weekly rate)? How do the Nation's families survive in 1947 on a median money income of only \$2,300 (Federal Reserve Bulletin, July 1947, p. 802)?

These are serious questions. I do not suggest that the great mass of American workers are meeting their "absolute living requirements" on the low incomes paid them by industry. But I do suggest that those who have spendable incomes anywhere from 3 to 40 times greater are not speaking in good faith when they argue that present taxes take "practically everything above their absolute living requirements."

Second, is it true that there is "practically no new capital coming into industry"? The SEC reports that corporations issued 6.2 billion dollars in new stocks and bonds in 1947, the second highest total since 1920. More than half this amount was earmarked to be spent on new plants and equipment (Washington Post, January 29, 1948). Two-thirds of the total offerings were for new money. Secretary Harriman told the House Ways and Means Committee on January 19, 1948, that "individuals in 1947 added \$600,000,000 to their securities portfolios, mostly in the form of stocks" (hearings, p. 151). Life-insurance companies, an important group of investors, added \$2, 00,000,000 to their investments in corporate securities. Banks added \$400,000,000.

Those who plead for special tax relief to encourage investment point with alarm to the fact that in 1947, corporations obtained 68 percent of their new funds from bank loans and bonds, and only 32 percent from stock issues. But the same thing happened during the 1920's, without stalling industry; from 1919 to 1928 only 32 percent of new money was raised through stocks, the same proportion as in 1947, and 68 percent through bonds. As Secretary Harriman pointed out; one very good reason for this is "the very cheap money that can be obtained at the present time, and corporation directors naturally are taking advantage of it" (hearings, p. 165).

Third, is industry "living off itself, just as a camel, in periods of famine, lives off its hump"?

What most disturbs the pleaders for tax relief on high incomes is the fact that corporations in 1947 financed their expenditures on business facilities largely out of undistributed profits and depreciation reserves. Out of the \$20, 000,000,000 of corporate funds spent on plant, equipment, and inventories, etc., \$14,800,000,000 came from these two sources, compared with only \$7,200,000,000 raised through stocks and bonds and bank loans (hearings, p. 150). The view with special alarm the fact that in 1946, corporations spent \$6,500,000,000 of their cash and Government securities.

The main point here is that corporations came out of the war, after the five bonanza profit years 1941-45, with a pretty big "camel's hump." Even after spending \$6,500,000,000 in 1946, corporations held \$30,100,000,000 in cash and Government securities, compared with only \$13,000,000,000 in 1939. Corporate working capital—current assets (cash, Government securities, accounts receivable, and inventories) minus current liabilities (accounts payable, accrued taxes, wages, interest, and other expenses), was grown without interruption from \$25,000,000,000 in 1939 to \$60,000,000,000 in 1947.

It is no wonder that Secretary Harriman concluded:

"Since business needs for investment are being reasonably met with no evidence of a lack of means of financing by business, I do not believe it is meaningful to say that there is a shortage of savings to satisfy business needs" (hearings, p. 153.)

I think these facts knock into a cocked hat the NAM argument quoted at the beginning of this discussion on venture capital. There is nothing to the argument except camouflage for tax relief for high incomes. Our tax system is actually quite favorable to "venture capital"; capital gains are taxed at the low rate of 25 percent, while income from bonds is taxable at regular income-tax rates. If anything is holding investors back, it is not so much taxes as their own doubts as to the profitability of investment. The main reason there are tire doubts is because there is fear that present levels of production will fall. The main reason they may fall is because the wage and salary incomes of 90 percent of the American people are too low to sustain a mass market for the products of American industry. Hereafter investors should be out rooting for tax relief for low incomes, instead of seeking to shift more of the tax burden onto low incomes.

When the special pleaders talk of encouraging equity capital so as to expand our productive capacity, I wonder whom they think they are fooling? Everyone knows that fear of excess capacity dominates corporate industry. Our manufacturing and mining industries expanded their physical facilities by one-third during the war (Federal Reserve Bulletin, September 11, 1948, p. 988). On top of that, we have had 2 years of record investment in plant and equipment, during 1946 and 1947—sufficient, in Secretary Harriman's words, "for replacement and normal growth," and "It also covers some making-up of the deficiency accumulated during the war" (hearings, p. 147). Our auto industry, which expanded its facilities 65 percent during the war, operated last year at only about 60-percent capacity, according to Ward's Automobile Reports (United Automobile Workers-CIO Research Report, May and October, 1947). The fear of excess capacity was clearly shown in United States Steel's 1946 report to stockholders:

"If the record of the past is any measure of the future, United States Steel has entered a period of peace in which the long-term outlook is for the average use of about two-thirds of its capacity, with relatively inadequate provision for future needs having been made during recent periods of maximum production" (p. 24).

The steel price rises of the past year—the latest announced on February 20, 1948—reflect Big Steel's policy of "making provision for future needs" by high prices and profits, rather than by expanding production. When Mr. Grace, chairman of Bethlehem Steel Co., appeared before the Senate Small Business Committee on September 12, 1947, he suggested that instead of increasing American steel capacity, "We ought to have had double the production in the Ruhr (Germany) by this time" (Senate Small Business Committee hearings, September 11 and 12, 1947, p. 2020).

Secretary Harriman hit the same idea in these words:

"From a business standpoint, investment in plant and equipment has to be made on the basis of long-term requirements. If it isn't, the overly expanded industries will find themselves in serious difficulties in the not too distant future. The high rate of growth (of plant and equipment) from 1922 to 1929 * * * was a significant factor to be kept in mind in relation to what happened in 1929" (House Ways and Means Committee hearing, p. 140-147).

The NAM and other leaders for tax relief to encourage capital expansion know very well that industry can't afford to expand unless it is sure of a market. Their double talk really adds up to a convincing argument for the opposite kind of tax relief they are asking for.

THE REQUIREMENTS OF CONSTRUCTIVE INCOME TAX ADJUSTMENT

We should not wait for another round of price breaks to convince us of the fundamental unsoundness of our present economic situation. We should take steps immediately to cut consumption on a sound, long-range basis. Tax reduction concentrated in the lower-income brackets could be an important contribution to general welfare and economic stability by releasing several billion dollars for consumption of necessities. When you take \$105 from a \$2,500 income today you are literally taking milk from babies—and also clothing, education, and medical care.

I believe we should strive as a matter of principle to exempt from Federal income tax all income necessary to meet the family living standards of the BLS and Heller committee budgets. Taxes should be taken to the greatest extent possible from income which is surplus to the needs of human subsistence. That is the essence of a progressive tax system (cf. TNIC Monograph 20, Taxation, Recovery, and Defense, p. 80).

During the war we departed a long way from progressive tax principles. In 1939 a married couple enjoyed exemption on the first \$2,500 of income. To give a married couple the same exemption today, in terms of goods and services, would require an exemption of \$4,250 to cover the more than 70-percent increase in consumer prices since 1939. Instead, a married couple's exemption today is only \$1,000, equal to about .590 of 1939 purchasing power. Compared with 1939, a married couple enjoys an exemption in terms of goods and services equal to only 28 percent of their exemption in 1939.

In the case of a family of four, the exemption in 1939 was \$3,800. The exemption today is only \$2,000. In terms of goods and services the current exemption is worth only \$1,180—or 30 percent of the 1939 exemption.

The first order of business in tax reduction should be to move toward the more progressive tax system prevailing in 1939. Compared with that objective, the recommendations of the UE and the CIO are modest.

We recommend an exemption of \$1,500 for a single person. The equivalent exemption, in terms of goods and services which the exemption would buy in 1939, would be \$1,700.

We recommend an exemption of \$3,000 for a married couple. The 1939 equivalent would be \$4,250.

We recommend maintaining the exemption of \$500 for each dependent. For a family of four, that means total exemption of \$4,000. The 1939 equivalent would be \$5,600.

THE DINGELL BILL IS A STEP IN THE RIGHT DIRECTION

In this connection the Dingell bill (H. R. 4068) must be recognized as a constructive, though temporary, step in the direction of providing relief where relief is needed. According to Secretary Snyder's statement to this committee, the bill would exempt some 10,342,700 persons from Federal income tax in 1940, and would concentrate 83 percent of the tax reduction proposed (\$3.2 billion) in the income classes under \$5,000 (statement of Secretary Snyder, March 1, 1948, exhibit 10, p. 89). It also provides a much-needed reenactment of the excess-profits tax which "in view of the record earnings of some corporations . . . appears to be a sound solution both on equity and economic grounds" (Snyder statement, p. 8). When we consider that corporate income before taxes has risen from 10 percent of private national income in 1939 to 15.5 percent in 1947 (Survey of Current Business, February 1948, p. 7), it is obviously out of line for corporate income taxes to contribute a smaller share of Federal revenue in fiscal 1948 than in fiscal 1939 (see table 0, this statement).

The weakness of the Dingell bill is that it does not provide for permanent improvement in the tax structure by raising exemptions. The \$10-tax credit is a one-shot affair and is given to all taxpayers across the board regardless of need.

In view of the fact that a large portion of our taxes is now going to pay interest on the Federal debt, which is in the main a form of subsidy to banks, insurance companies, and wealthy investors, it is time to think of applying present large revenues to debt reduction. The corporations which are profiting from inflation provide the logical source for the bulk of revenue to be applied to debt reduction.

OVER-ALL U TAX PROGRAM

I realize that the committee is limiting itself at this time to reduction of individual income taxes. However, we cannot postpone too long a thorough overhauling of the entire Federal tax structure. As I have suggested, the first step in such overhauling would be to reestablish the more progressive tax structure of 1939. When individual income taxes, accounting for only 18 percent of Federal revenue, placed far less burden on low incomes, while corporate incomes contributed a greater share than they do now. It is also obvious that estate and gift taxes, contributing only 2 percent of Federal revenue in fiscal 1948, continue to be a profitable form of tax avoidance used by what President Roosevelt, in his tax message of June 1, 1937, called "upper bracketeers."

As a step toward the kind of tax structure which is consistent with high levels of production, employment, and consumption, the 10-17 UE Convention unanimously endorsed the following tax program:

1. That no person shall pay Federal or State income taxes on any income below that required to support a decent standard of living. This means exemptions of at least \$3,000 for married persons, \$1,500 for a single person, and \$500 for each dependent.

2. All taxes on consumption of the necessities of life, such as sales taxes and excise taxes, should be eliminated.

3. To curb the present exorbitant profiteering at the expense of the people's living standards, the corporate profit tax should be restored on a basis similar to that used during the war.

4. Large corporations should provide a greater share of the necessary revenues of government, through higher rates of corporate income tax and station of undistributed profits. Businesses earning less than \$25,000 should be encouraged by reduction of their tax rates.

5. Loopholes in the present tax structure should be closed. Mandatory filing of single returns for a non-attached wife in all States, by effective taxation of capital gains, by abolishing tax-exempt securities, and reduction of estate and gift tax exemptions to \$25,000 (U. S. Policy 147-48, 17).

TABLE 1.—Distribution of Federal income tax burden in 1939, under present law, and under H. R. 4790

Net income class	Percentage of tax liability		
	Present law	H. R. 4790	Ratio
Under \$2,000	13.7	11.2	
to \$5,000	5.0	5.0	
to \$10,000	17.7	12.3	69.4
to \$25,000	17.7	23.6	133.3
to \$50,000	46.9	43.8	93.4
Total	90.2	43.88	50.6

¹ Assuming total personal income of \$309,000,000,000.

Sources: Treasury Department, Statistics of Income for 1941, pt. 1, p. 239; H. Rept. 1274, 80th Cong., 2d sess. (report to accompany H. R. 4790, Jan. 27, 1948), p. 28.

TABLE 2.—Number of taxpayers on Federal tax rolls

(In thousands)

Net income class	Present law	H. R. 4790	Ratio
Under \$2,000	8,410.7	20,813.5	247.5
to \$5,000	1,000.0	17,199.1	171.9
to \$10,000	1,414.0	1,202.1	85.0
Subtotal	10,824.7	39,214.7	362.3
\$10,000 to \$25,000	484.7	1,877.9	387.4
to \$50,000	64.7	672.1	1,038.8
to \$100,000 and over	44.2	174.4	394.6
Subtotal	593.6	2,424.4	406.8
Total	7,800.0	4,728.0	60.6

¹ Assuming personal incomes of \$1,000,000,000.

Sources: Treasury Department, Statistics of Income for 1942, pt. 1, p. 235; H. Rept. 1274, 80th Cong., 2d sess. (report to accompany H. R. 4790, Jan. 27, 1948), p. 28.

REDUCTION OF INDIVIDUAL INCOME TAXES

TABLE 3.—Distribution of tax relief under H. R. 4790

Net income	Percent of re.		
	present tax payers	total seller	relief per taxpayer
Under \$2,000	38.	10.4	91.7
\$2,000 to \$5,000	31.4	21.9	95
Under \$5,000	95.0		99.4
\$5,000 to \$10,000	2.9	1	7
\$10,000 to \$25,000	1.2	8	860
\$25,000 and over	.3	12.7	4,740
\$5,000 and over	4.4	28.4	70

† Including total exemption for 7,399,100 taxpayers under \$5,000.

Source: H. Rept. 1274, 80th Cong., 2d sess. (report to accompany H. R. 470, Jan. 27, 1948), p. 28.

TABLE 4.—Increase in spendable income under H. R. 4790 (married couple, 2 dependents)

Net income before exemption	Spendable income		Percent increase
	present law	H. R. 4790	
\$0	\$2,000	\$2,000	
\$500	2,405	2,497	3
\$1,000	2,810	2,920	4
\$1,500	3,220	3,370	5
\$2,000	4,411	4,614	5
\$10,000		3,79	8
\$15,000		2,68	3
\$25,000	16,470.79	19,80	20
\$50,000	24,400	24,01	21
\$250,000	59,525	98,821.21	66
\$500,000	60,300.00	110,774.4	60
\$1,000,000	93,400	150,000	67
\$2,000,000	161,150.4	267,038.3	66
\$5,000,000	725,000.00	1,184,833.1	69

Source: H. Rept. 1274, 80th Cong., 2d sess. (report to accompany H. R. 470, Jan. 27, 1948), p. 17.

TABLE 5.—Effect of income splitting (married couple, no dependents)

Net income before exemption	Tax payable		Saving with split return
	Joint return	Split return	
\$0	\$190	\$19	
\$50	285	28	
\$100	380	380	
\$150	681	570	\$111
\$200	8798	7600	31
\$250	1,0458	907	76
\$300	1,677	1,397	190
\$350	2,185	1,843	342
\$400	9,082	6,460	2,622
\$450	14,72	18,724	6,071
\$10,000	148,121.4	127,083	21,037.13
\$20,000	407,468.4	383,648.2	23,820.2
\$50,000	839,716	815,794	23,921.7
\$100,000	1,704,918	680,291	33,921.1

Source: H. Rept. 1274, 80th Cong., 2d sess. (report to accompany H. R. 470, Jan. 27, 1948), p. 28.

TABLE 6.—Sources of Federal revenue

(Millions of dollars)

Type of tax	Fiscal 1947		Fiscal 1948	
	Total	Percent	Total	Percent
Individual income	1,020.9	18.	21,051.51	48.4
Corporate income	1,277	22.	9,514	21.1
Sales and other taxes	1,755	30.4	7,320	16.2
Estate and gift	361	6.4	842	1.9
Employment	741	13.0	2,430	5.3
Customs	310	5.6	304	.9
Other	187	3.3	2,745	6.1
Total	5,668	100.0	45,210	100.0

Sources: Statistical Abstract of the United States, 1947, pp. 320, 322; House Committee on Ways and Means hearing on H. R. 4700, Jan. 10, 1948, pp. 57, 61.

Mr. NIXON. First, Mr. Chairman, I would like to express my appreciation for the opportunity to appear again this year before the Senate Finance Committee on the tax question.

I appreciate the attendance of yourself, Senator George, and Senator Overton, at this testimony.

It has been about a year since Congress last discussed tax reduction and since I was here to testify.

In that year, we have had an experience of high inflation which has had an increasingly serious impact on the living standards of the American people and on the stability of our economy.

It has created what the previous witness referred to as humanitarian problems in terms of millions of American families.

It is our opinion that the developments of the past year have served to underline and emphasize the general point we made a year ago when we came before this committee to testify on what was the H. R. 1.

We feel that this is true because at that time we emphasized the very grave problem of the average American meeting his cost of living from his income and tax burden.

This, of course, has increased in difficulty as a result of the rise in prices in the last year.

In addition, a year ago, we emphasized the uncertain prospects of continued high production in the economy, the uncertainty on which our economy rested in terms of the future prosperity, and it is our feeling that we are even in a more dangerous position as the year has passed than we were a year ago, and these thoughts underline our general presentation.

It is our feeling that a sound tax measure at this time can do a great deal to grant relief from the high living costs that the average person is meeting, and to sustain consumption. There is no question that the present tax drains off too much purchasing power from the low-income people.

In the low incomes, taxation is making a definite impact on the healthy existence, on the minimum standard of living of millions of American families.

We feel that the readjustment of the tax program so as to provide this relief is the central issue in taxation today.

The simple issue is whether relief is to be granted exclusively to the victims of inflation, or whether such relief will be dissipated in the form of a hand-out to the beneficiaries of inflation.

This, we think, is the basic issue and one that must receive the attention of the entire committee.

In this respect, we feel that H. R. 4700 does not provide adequate relief where it is needed.

The basic criticism is H. R. 4700 provides relief in reverse ratio to the order in which the tax burden was extended during wartime.

As you know, during wartime, there was an extension, and necessarily so, an extension of the burden of taxation from the higher income brackets to the lower income brackets, with the result that in 1939, the incomes under \$5,000, which paid less than 10 percent of the Federal income taxes, pay under the present law something like 55 percent.

If you also make adjustment for the increase in prices which has occurred since that time, the conclusion is emphasized.

The group whose real income and living standards are measured today at \$5,000 or less—and they are equivalent to those receiving \$3,000 in 1939—is carrying over 10 times the share of Federal income taxes paid by the group with comparable living standards in 1939—55 percent compared with 5 percent.

I would like to emphasize that point and make sure it is understood.

I am making the point that the family with \$5,000 now has about the same standard of living, given the rise in prices, as the family who had \$3,000 in 1939, and I am comparing the shift in the burden of the taxes in those income groups—\$3,000 in 1939 and \$5,000 now—to get some guide to the shift in the relative burden of these income groups.

I make the point that under the law, as you have proposed it, the increased burden of the low-income families that arose during the war from approximately 5 percent to 55 percent is only very infinitesimally reduced, and that under the law which you have before you as proposed—H. R. 4700—you would still have low-income people below \$5,000 paying about 10 times the share that they carried in 1939—55 percent compared with 5 percent.

Our basic position is that the law in terms of the income-tax category should be so changed as to begin a significant reversal of this tendency back to the proportionate share that was carried by the low-income people in 1939.

The CHAIRMAN. How much revenue were we raising in 1939?

Mr. NIXON. Of course, you were raising a much smaller revenue with a much smaller national income, which applied to high incomes and to low incomes.

I am not saying, if you will notice, Senator Millikin, you can go back exactly to that 1939 situation, and you will find in our presentation we do not make that proposal.

I do not think it is practicable to go back to a 5-percent share.

The CHAIRMAN. Let us get one or two more basic facts into the record.

Under the bill which is before us, what percentage of the reduction goes to taxpayers of less than \$5,000?

Mr. NIXON. Seventy-two percent.

The CHAIRMAN. Seventy-two percent.

Mr. NIXON. That is one estimate. There is some discrepancy, depending on national income.

The CHAIRMAN. You are not contending that the taxes which those taxpayers pay could be shifted to the brackets above \$5,000 are you?

Mr. NIXON. No; I am suggesting that the 28-percent reduction that goes to those above \$5,000 could better be allocated to those under \$5,000, and in this way to make a significant step toward a reversal of the present proportionate share back toward the share of 1939.

It is a question of degree.

The CHAIRMAN. Of course, that all comes to the same thing, it seems to me.

If you have a given sum of money, out of which you can make a reduction, if you do not make it all the way along the line, obviously you are shifting the burden from one segment of the bracket to another segment of the bracket.

Mr. NIXON. I would put it, you are shifting the removal of the burden.

The CHAIRMAN. It comes to the same thing.

Mr. NIXON. I would not quarrel with you on that. I would remove the burden completely from the under \$5,000 category.

The CHAIRMAN. Do you believe that the present rates above \$5,000 are rates which are consistent with the maintenance of a dynamic economy in this country?

Mr. NIXON. Yes, I do, sir. I am coming to the question of venture capital in a short time.

The CHAIRMAN. Go ahead.

Mr. NIXON. I only wanted to underline the point I have just made, that at specific income levels, the relief provided by H. R. 4790, would result in an increase of expendible income of 3 percent for a family of four at \$2,500 a year income, and range up to 67 percent for a family of four at \$500,000 income.

I am perfectly aware of the limitations that mathematics gives us in equalizing those figures.

What I am suggesting is that, by putting all the decrease in the category below \$5,000, we could get a more equitable distribution of the tax reduction.

The CHAIRMAN. Whether equitable or not, your point is to take whatever reduction is possible and put that in the brackets below \$5,000?

Mr. NIXON. That is right. That is the point.

The CHAIRMAN. That is your point?

Mr. NIXON. Yes, sir.

The basic reason for that, which I have stressed before, before this committee, and do not intend to go into in great detail here, is that when you get into income levels of families of three or four thousand dollars or even below that, you are talking about people who are not being able, under their current income and current tax burden, to maintain minimum standards of living, such as has been scientifically determined both by our governmental agencies and by research agencies, professional institutions such as the University of California, the Heller Institute.

When we levy taxes on these low income brackets, we are in a very real sense, levying a tax on the basic consumption of the people.

We are in a sense levying a tax on whether or not a family has enough food to eat; whether or not a family has adequate clothing and medical care.

We are not levying a tax on a luxury, but on things that we, as Americans, would think are basic.

The basic emphasis I want to put here is that we should move as quickly as possible toward a readjustment of our tax burden so as to not impinge on incomes of this group, lest the decrease then below the level adequate to meet the basic standard of living as it has been determined by the most scientific, careful evaluation of what a nutritional healthy budget for a family is.

I have emphasized this point before the committee before, and I want to emphasize it again, because I know that in the minds of millions of Americans, surely this is the issue of taxation and this is the humanitarian issue that we have to face when we make the difficult choice of which family carries the load.

I would like to say it word on the question of income-splitting for all States, and then on the question of estate and gift taxes.

I know you have been listening today to a group of men who are experts in discussing some of the technicalities of these two proposals.

I do not want to attempt to discuss the technicalities, but I want to make this point, that both the proposals to apply the mandatory joint returns in all States, or to preclude the mandatory joint return in all States, and to widen the loopholes in the estate and gift taxes, are regressive moves in our proposals.

The reason they are regressive is that the relief they would bring is concentrated exclusively in the upper-income brackets of our population.

As Secretary Synder testified before the House Ways and Means Committee, income splitting would result in a revenue loss of more than \$803,000,000. Ninety-seven and one-half percent of that would go to individuals with net incomes above \$5,000.

We submit that in economic instances such as we face right in this country to initiate a tax adjustment which is so completely to the benefit of the high-income brackets of our country is contrary to what is needed, both in terms of standards of living of the people and in the health of the economy.

The argument is often made that this needs to be done for purposes of equalization.

It is a curious approach to the problem of equalization. It is a problem of equalization in which the tail is being asked to wag the

There are 35 non-community-property States, and the 35 are being used to change in order to adjust to the condition in the 13. It would seem more logical from my point of view to ask the 13 to make the change if it is equalization we are interested in.

The CHAIRMAN. I might say that Congress has attempted that several times without success.

Mr. NIXON. Thus far, the reverse has been attempted as well as that also, and without success, and the problem still rests with the Congress—which way are you going to jump?

I have noticed with a good deal of concern the shift in the administration's emphasis, shall I say, on this particular question, because I know that for years, Mr. Morgenthau, when he was in Mr. Roosevelt's Cabinet, and his representatives, came here and argued vehemently for the retention of mandatory joint returns in all States.

I have been disturbed in the past year or so to see an apparent end of that positive position on the part of the administration, and an in-

elination at least to go along with the adaptation of the community-property provision in all the States.

I think that is just this kind of taxation issue where the Congress is forced to choose between relief that benefits low-income people and relief that benefits large-income people in which we have the real core of the tax issue.

The same applies to the question of the revision of the estate and gift taxes.

I do not wish to argue technically this particular provision.

The simple fact is that the estate and gift tax provisions in H. R. 4700 would benefit only those will testate estates of \$60,000 or more and those who make gifts exceeding \$30,000.

I understand that this provision would potentially reduce the taxes of wealthy persons by \$250,000,000; reduce the total yield of estate and gift taxes approximately 30 percent potentially.

Here again, I make this same basic point. While we can be concerned, and must be concerned, with equity and justice in the high brackets, and in cases such as Mr. Pierson just mentioned to us, we have to have a really realistic evaluation of the way in which we use the term "humanitarian" who we are talking, on the one hand about the concededly difficult problem of a widow who has the problem of adjusting herself to the problem of a \$100,000 estate, but we must not in concern for that type of humanitarian problem ignore the less dramatic, less specifically and less edifying, of millions of American mothers who are disturbed week by week with their incapacity to buy enough milk for their children, or to take their kids to the dentist, or to meet their medical care otherwise.

I know it would be a much happier world if we did not have to face problems of this sort. It would be happier if we did not have taxes at all. The simple fact remains we do have this kind of a choice.

The Chairman. The question is, how to face them in the soundest

Mr. NIXON. That is right, exactly, and by soundness, we mean with proper consideration to human interests involved.

The Chairman. I suggest to you that the place where idealists always fall on their faces is where they do not realize you cannot achieve the ideal on an unsound economy.

Mr. NIXON. In that case, I would want to disavow the appellation of idealists.

The Chairman. I see nothing wrong with it. It is a very fine label.

Mr. NIXON. If that is what idealism means, I want none of it, because it is so unrealistic that in our work, where we represent, in my case, 600,000 workers, we do not have any room for unrealistic idealism. We have to be practical, sir.

The Chairman. I suggest to you the only way in the long term that the people you represent can meet their dentist bills, and food bills, and shelter bills, and insurance bills, and so forth, is out of jobs, by means of having jobs.

I should like to suggest to you the only way you can have jobs is to have a sound economy, and I should like to suggest to you the only way you can have a sound economy is to have a source out of which you can get investment or risk capital.

I have forgotten the number, but I think 700,000 new workers come in your worker field every year who must have a \$5,000 or \$10,000 machine, and they can't not give them work unless you buy the machine. You can not buy the machine unless you buy it out of the Federal Treasury, or unless you get it out of private sources.

And I suggest the only place you can get it out of private sources is the middle and upper brackets.

I suggest when you unduly penalize those middle and upper brackets, you are negating everything you are talking for.

Mr. NIXON. I understand the course you are making, Senator Millikin. Initial evaluation lies a great deal of argument and judgment between people as to how you achieve these purposes.

I would want to point out this argument of venture capital, and the maintenance of an atmosphere permitting venture capital is, with only minor modifications, the argument the National Association of Manufacturers hits always brought to bear before the Congress on spending money in New Deal days.

The CHAIRMAN. The NAM is entitled to be right police in a while.

Mr. NIXON. I suppose that is true. I would not want to agree on that.

The CHAIRMAN. So are you.

Mr. NIXON. I know that as a concession on your part.

I would not want to make the same concession to the NAM, although you may be right about that.

The point I want to make, however, and it is not irrelevant to the question of venture capital, is that this general argument, this framework of approach to the need of our economy, is the same framework that was heard here in the argument against spending more money in the New Deal days. Exactly the same.

The same argument that was used before the Banking and Currency Committee by the NAM against the continuation of price controls, where they said what they needed was removal of price controls in order to encourage expansion by industry in order to produce.

It is the argument which has been used almost without exception whenever the special interests of industry generally are being considered by the Congress.

The CHAIRMAN. It does not matter who is responsible for the argument. The question is whether it is sound.

Mr. NIXON. That is correct.

The CHAIRMAN. Your burden is to show how you can keep the economy going under your theory. So far I would suggest you have not met your burden.

Mr. NIXON. I would suggest that is because I have not yet completed my statement, Mr. Chairman.

The CHAIRMAN. I am waiting.

Mr. NIXON. What about encouraging venture capital?

As you have pointed out, the principal argument for tax reduction is the argument that present tax laws stifle investment, forcing corporations to buy plant and equipment out of undistributed profits and depreciation reserves or through bank loans and bonds, rather than by selling stocks.

I would like to discuss this particular argument which has as its first general point that the present tax laws take from the investing class practically everything above their absolute living requirements.

If you will just look at the schedule on tax payments on the various income categories, you will find there is a considerable margin left that goes above what we can justifiably refer to as absolute living requirements.

At \$10,000, spendable income is \$7,815.

At \$15,000 spendable income is \$10,953.

At \$25,000 spendable income is \$15,918.

At \$50,000 spendable income is \$25,205.

At \$100,000 spendable income is \$36,872.

At \$250,000 spendable income is \$58,660.

The CHAIRMAN. That is a pretty good take, is it not?

Mr. NIXON. That is more than I ever expect to see. That is for a man with a wife and no dependents.

To people like the people in my industry, whose incomes average, and who live and raise families, as the bulk of the American people do, on an average income of around \$2,400, it seems to us that even our present tax schedule does not reduce the income of people in that bracket to what the NAM called their absolute living requirements.

The CHAIRMAN. What is the spendable income, the disposal income of a \$2,500 man with a wife and two children?

Mr. NIXON. I was speaking here of a man with a wife. A man with a wife and two children has practically his whole income.

The CHAIRMAN. The whole income?

Mr. NIXON. That is right, and he lives at that level.

The point I am making is, while we do not think it is adequate, it is the level at which the bulk of the American people exist, and it raises a question about whether you can justifiably say the present tax schedule does reduce the high income—

The CHAIRMAN. You could not do any better for a man in that category, obviously, unless you paid him a bonus?

Mr. NIXON. At this point, we were talking about the other man, about the man who has a high income, and I was addressing myself to the argument sometimes made that present tax schedules are so high he can just barely exist.

The CHAIRMAN. Do you mind if I interrupt you?

Mr. NIXON. No, sir.

The CHAIRMAN. Do you favor the Truman bonus plan?

Mr. NIXON. I was coming to that.

The CHAIRMAN. Go ahead. I will not interrupt you.

Mr. NIXON. That is all right. I will answer you right here, since you ask the question.

I think it is in the right direction. I have some limitations about it, but I think it is in the right direction.

The CHAIRMAN. Do you think you ought to throw in a mule?

Mr. NIXON. A lot of our people would probably eat the mule, the way things are today, if you threw one in. We will take anything we can get, Mr. Chairman.

The second point, sir, is the point there is practically no new capital coming into industry.

Now, the Securities and Exchange Commission reports that corporations issued \$6,200,000,000 worth of new stocks and bonds in 1947, the second highest total since 1929, and more than half of this sum was earmarked to be spent on new plants and equipment.

The point that I want to make here is that there is no statistical justification for the statement that now capital is not coming into industry. This is a purely factual question that seems to me should be beyond discussion.

The statistics are clear that industry is getting new capital.

In 1947 they got new capital at the highest level since 1929.

The CHAIRMAN. Getting indebtedness capital and not equity capital. Indebtedness capital in a period of recession will shut your workers off the pay rolls.

Mr. NIXON. I am not sure that equity capital would prevent that. We had plenty of equity capital in 1929.

The CHAIRMAN. It might not prevent it, but it might defer it.

We will recess while we proceed to the floor for a vote.

Mr. NIXON. I was addressing myself to the point you yourself had raised, the question of the impact of the tax structure on investment capital, venture capital.

I had made the first point that the present tax schedule does not reduce the spendable incomes of people to such a level as to leave them no margin for investment.

I was making the second point that it is not true there has been no new capital coming into industry, and I pointed out the high volume of stocks and bonds that had been purchased in 1947.

You made the point that a substantial portion of this was bank loans and bonds, which is correct.

In 1947, corporations obtained 68 percent of their new funds from bank loans and bonds and only 32 percent from stock issues.

The point that has been made here is that from 1919 to 1928, only 32 percent was raised through stocks, the same proportion as in 1947, and 68 percent through bonds.

As we know this was not a period in which investment capital, or venture capital, was stifled in this country.

The CHAIRMAN. In 1947 and 1946 there was practically no investment in equities. Is that not true?

I am not speaking about preferred stock issues, but I am talking about straight equities.

Mr. NIXON. I only have the figures here for stock issues. I have not the break-down for the common and preferred stock, but it was 32 percent in total stock issues in 1947. That is the same proportion as characterized our investment market in the years 1919 to 1928.

The CHAIRMAN. I think you will find that so far as straight equities are concerned, the amount of equity investment in both 1947 and 1946 was practically nil.

Mr. NIXON. The point, of course, about that, is, as Secretary Harri- man pointed out, they can get very cheap money at the present time, and under those circumstances, corporation directors are taking advantage of it.

The CHAIRMAN. They take advantage of it in part for that reason, and I suggest, Mr. Nixon, in part because they cannot get equity.

But you know very well the effect of that is two-fold: In the first place, it is apt to overextend the credits which the banks give to industry and which in periods of recession must be severely contracted to preserve soundness of the bank, which has a very bad effect on industry.

In the second place, it puts a fixed charge against industry which is a priority charge which must be met, which in times of severe recession put industry in the hands of the banks.

Mr. NIXON. I think that is an auxiliary aspect of the problem.

The CHAIRMAN. And the larger you increase your indebtedness part of any financial structure, the less attractive for those reasons, and others, you make your equity investment.

Mr. NIXON. I can only suggest, as I will try to emphasize in just a moment, I think that is not the decisive question in regard to our investment decisions.

The further point has been made that industry is living off itself just as a camel in periods of famine lives off its hump. But is based upon the fact that a great volume of investment in 1946, \$6,500,000,000, was out of their own cash and Government securities.

The point I want to make here is tile corporations came out of tile war after live bonanza profit years with a pretty big hump, and even after spending \$6,500,000,000 in 1946, corporate ions held \$39.1 billion in cash and Government securities, which is to be compared with only \$13,000,000,000 in 1939.

The corporate working capital, current assets minus current liabilities, has grown from \$25,000,000,000, in 1939, to \$60,000,000,000, in 1947.

I think these are tile factors in tile background which let Secretary of Commerce Harriman—and I remind you he is not a C. I. C. official; he is a fairly well known financier and a man with a business background—to say, and I quote him:

Since business needs for investment are being reasonably met with no evidence of a hick of means of financing by business, I do not believe it is meaningful to say that there is a shortage of savings to satisfy business needs.

This is a statement of Mr. Harriman. I think we have to either refute this statement, responsibly made by a responsible Government official of business background, or we have to question the credibility of tile general business complaint that the tax structure is tampering with and hampering their investment and expansion process.

The CHAIRMAN. I suggest that the record already has refuted it, and I suggest there will be considerably more testimony that will complete the refutation if it is not already complete, and it will go along the lines which I have indicated to you.

Mr. NIXON. I assume, then, that joins the issue perfectly well, and it evidently is one of judgment.

The only point I would want to make, not to presume to present more expert opinion than tile Department of Commerce or Mr. Harriman, that to labor it is an interesting thing that one argument here serves as a convenient justification for lessening the taxes of tile rich people and maintaining relatively the burden on tile poorer people; and we have to raise the question with this kind of an argument whether the argument is being cut to fit the desires of industry rather than their needs. And we have to confront the very realistic evaluation of what are the merits of the particular arguments.

The CHAIRMAN. In making our comparison between cash reserves now as against prewar days, I want to invite your attention to the fact that your total taxable net income, in 1939, was some \$15,000,000,000, whereas total taxable net income is now in the sum of \$132,000,000,000.

Mr. Nixon. I realize that.

The fact remains that the liquid assets available are really tremendous, and they certainly do not seem to me to square with the general picture of the situation which industry would try to create here: that you have got a situation where American industry is crying for the opportunity to invest; they have got all sorts of schemes they want to finance; they want to expand the steel industry; they want to expand the automobile industry; and they want to expand all of our industries; and they are being held up because they cannot get the finances to do it because of a tax structure.

I think this picture does not conform with the facts today.

We are not being pressed for that type of expansion, and we are not finding that we are failing to expand for those reasons.

This does not conform to the readily recognized difficulties of our present situation.

The problem we have got now is that the people who want to invest are ill doubt about the future of the economy. The people who want to invest are not certain that we are going to a continued optimistic production situation.

Just, for example, I know the Journal of Commerce has been writing editorials about the need for equity stock issues. But they themselves, in my opinion, give the answer on this when they wrote in their December 22 issue, and I quote:

What we do not like about the present business picture is the fact that the volume of unit retail sale is showing a persistent downward trend. If more goods are being produced than sold, that cannot go on forever.

That is the Journal of Commerce speaking, and I think here you get to the crux of the issue that I am trying to emphasize.

This, of course, is the traditional issue that we always argue with the NAM when we come before congressional committees.

The CHAIRMAN. You do not argue with NAM when you are before this committee. You are arguing with this committee.

Mr. Nixon. I do not want to quibble with you, sir.

The CHAIRMAN. There is no quibble about that.

Mr. Nixon. Let me restate it: There are generally on these questions two points of view presented to this committee. There is a point of view such as we of labor present and which is, we emphasize, the need for greater consumption outlets and the need for maintaining mass purchasing power, and we maintain to do that you have to reduce the taxes on the lower levels and not reduce them at the higher levels.

The CHAIRMAN. No one has a monopoly of argument. The NAM is entitled to its arguments, and you are entitled to yours, but when you are before this committee, you are addressing this committee and not the NAM.

Mr. Nixon. I am fully aware of that.

The CHAIRMAN. If you want to send any ricochet shots over to the NAM, that is all right.

Mr. Nixon. All right.

The CHAIRMAN. I would like to analyze your 39.1 figure.

In 1946, there were \$900,000,000 worth of common stocks that were new issues net after retirements.

In 1947, there were \$800,000,000 worth of new issues net after retirement.

Your 39.1 percent, and I do not remember whether that was it for 1946, and your 20.5 percent for 1947 relate to those figures.

So, taken by themselves, your percentages would give a very distorted view of the whole picture.

If you wish, I will put the whole table in the record to give you the complete picture.

Mr. NIXON. I would be delighted to have the complete picture, Mr. Chairman.

The CHAIRMAN. For 1946, there were \$900,000,000 new issues net of common stock; \$400,000,000 of preferred stock; \$1,000,000,000 of bonds and notes.

For 1947, there was \$800,000,000 of common stock; \$500,000,000 of preferred stock; and \$2,600,000,000 of bonds and notes.

And your percentages you have quoted relate to those totals.

Mr. NIXON. Let me repeat the point that I am making here: It is that in order to rectify this pall in the stock market, if we fail to take the adjustment measures that are possible to increase the standard of living and the purchasing power among the low income brackets, we will be aggravating a fundamental weakness in our present economic system, and we will be creating, or helping to create, or advance, because of the lack of purchasing power, the ultimate break that will seriously undermine the stock market, the employment situation, and every other aspect of our general economic situation.

The CHAIRMAN. I suggest that the sponsor of this bill before us, as it will be amended, are fully cognizant of the need for plowing back some of the taxpayers' money to the taxpayers so they can spend it themselves, and I think you will find a very generous allowance has been made for that.

Mr. NIXON. I am aware of the extent to which that is true at the present time.

I only just want to emphasize that as far as our judgment goes the reason why we are having difficulty in equity capital is because there is a growing fear about excess capacity, a growing fear of the lack of adequate margin, and this is what is retarding to retired our expansion.

This is arising from a growing concern about the continued mass purchasing power of the economy.

It is our opinion that to deal with this problem as far as taxes are concerned, we need to expand the tax relief to the maximum degree so as to maintain the purchasing power, the mass market of our economy.

That will be the crucial point of whether or not we maintain our stability or go back into economic crisis and depression. This is essentially the basis upon which we make our positive proposals.

Our positive proposals are to begin to restore as much as possible the exemptions that existed in 1939. During the war, we think, we departed a long way from progressive tax principles.

In 1939 a married couple enjoyed exemption on the first \$2,500 of income. To give a married couple the same exemption today, in terms of goods and services, would require an exemption of \$1,250 to cover the more than 70 percent increase in consumer prices since 1939.

Instead, a married couple's exemption today is only \$1,000, equal to about \$590 in 1939 purchasing power.

Compare with 1939, a married couple enjoys an exemption in terms of goods and services equal to only 23 percent of their exemption in 1920.

That is why we are urging that we give exemptions of \$1,500 for a single person, exemptions of \$3,000 for a married couple, and exemption for dependents of \$500.

This is below the amount that is necessary to achieve the 1939 equivalent, but we think it is a necessary step in the right direction.

Just a word as to the Dingell bill, about which you queried me earlier.

We feel that the Dingell bill is a constructive though temporary step in the direction of providing relief where relief is most needed. The CHAIRMAN. I do not remember querying you about the Dingell bill.

Mr. NIXON. That is the House minority bill, for the \$10.

The CHAIRMAN. I thought that was the Truman bill.

Mr. NIXON. No.

I want to be correct on this. It was introduced by Congresswoman Dingell H. R. 4968.

The CHAIRMAN. I accept the correction.

Mr. NIXON. Well, the concern we have about the Dingell bill is that, as Secretary Snyder emphasized to the committee over there, it is not a definite and unchanging change in the tax exemptions.

He proposed it as a temporary adjustment presumably to be dealt with later on.

In our opinion, what we need is a readjustment in the exemptions on a permanent basis to give a permanent kind of a readjustment in the exemptions along the lines I have emphasized.

The CHAIRMAN. Before you come to your conclusion, may I invite your attention to the fact that about \$103,000,000,000 of taxable net income goes to those under \$5,000 and about \$29,000,000,000 to those above \$5,000; and that the net effect of your argument, as I see it, would be an almost complete confiscation of the income of those above \$5,000, because we, at the present time, are raising about \$21,000,000,000 out of income taxes.

Mr. NIXON. I do not think you need to confiscate all the incomes above \$5,000 in order to put this kind of exemption into effect.

The CHAIRMAN. Let me ask another question.

If we should come up here with a bill which would, roughly, distribute the reductions, say, in the neighborhood of 70 percent to those under \$5,000 and the remaining 30 percent to those above \$5,000, would you rather have that than nothing?

Mr. NIXON. That is the bill you have before you, sir.

The CHAIRMAN. The Knutson bill does that?

Mr. NIXON. Yes.

The CHAIRMAN. And I am assuming anything we come up with will carry, roughly, the same percentage of distribution.

Mr. NIXON. You asked me that question last year.

The CHAIRMAN. Last year you said those in lower incomes would rather have that than nothing.

Mr. NIXON. I will give the same answer. I am aware of the fact Mr. Rutenbergs will give you a different answer.

The CHAIRMAN. As a result, your people have gone without about 2¼ billion dollars of income they might have had during the past year.

Mr. NIXON. I regret that.

The CHAIRMAN. Which is an infinitely greater gain than has been made by many of the strikes we have had to raise their income.

Mr. NIXON. You do not want to go off on that, do you, Mr. Chairman

The CHAIRMAN. Not very far.

Mr. NIXON. I would be happy to, but I do not think you do.

Let me say: It is clear from what I have said that we object to the kind of price that is being set in this bill for relief in the lower-income brackets.

I have made that clear and do not need to emphasize that any more.

We object to having it presented to us as an "either/or" proposition.

The CHAIRMAN. It is a practical question. You can judge as well as I can whether your theory will finally pass the Congress.

Mr. NIXON. Yes.

The CHAIRMAN. Assuming you judge it will not, would you rather have no aid for your people than that which is offered in the Knutson bill, or will be offered in some modification of it, presuming it carries, roughly, the same percentage of distribution

Mr. NIXON. I do not want to have any equivocation in my answer. I speak for my organization and my union. I would prefer to have the 72-percent relief for the people under \$5,000, which is in the present bill before you, to not having any relief at all.

The reason that I feel that way is—I feel very acutely the intense standard of living needs of low-income people; and I do not think we have room, in the face of this particular need, to turn down relief which would amount to 4 or 5 cents an hour increase equivalent, even though at the price of what I think is an unjustified tax relief on the upper-income brackets.

I want to be perfectly clear on that particular question.

The CHAIRMAN. I think you are making a very sensible answer.

Mr. NIXON. This is something we are very conscious of. It is not an off-the-cuff answer. We have talked about it and thought about it ever since last year.

The only point I want to make in closing, without going into it, is that we feel while you are, of course, considering only the individual exemptions, plus a couple of other auxiliary ideas such as the joint returns, and the estate and gift tax issue, that we must come very quickly to an over-all adjustment of the tax structure in which it will be possible to put into effect the other general proposals of tax relief that the United Electrical Workers and the CIO have from time to time proposed here; and some of the remarks we have made, I think, are only properly understood in the framework of what we think should be a general revision of the entire tax system.

The CHAIRMAN. It is always a pleasure to have you here, Mr. Nixon.

Mr. NIXON. Thank you.

The CHAIRMAN. Mr. Rutenber is our next witness.

Give your name, address, and occupation to the reporter, please.

STATEMENT OF STANLEY H. RUTTENBERG, ASSISTANT DIRECTOR OF RESEARCH, CONGRESS OF INDUSTRIAL ORGANIZATIONS, WASHINGTON, D. C.

Mr. RUTTENBERG. My name is Stanley H. Ruttenberg. I am assistant director of research in the National CIO in Washington.

I have a longer statement which I should like to request be submitted for the record, and because of the lateness of the hour and the discussion you have already had with Mr. Nixon, I do not think it is necessary that I read for the present the entire statement.

The **CHAIRMAN.** That is all right.

Mr. RUTTENBERG. I would like to have it submitted for the record.

The **CHAIRMAN.** We will put it in in full at this point in your remarks.

(The statement is as follows:)

STATEMENT ON TAXATION PRESENTED ON BEHALF OF THE CONGRESS OF INDUSTRIAL ORGANIZATIONS TO THE SENATE FINANCE COMMITTEE, BY STANLEY H. RUTTENBERG, ASSISTANT DIRECTOR OF RESEARCH, MONDAY, MARCH 8, 1948

I am happy once again to have the opportunity of appearing before this committee to present the views of the CIO on taxation.

Last year when I appeared before your committee I set forth the CIO's views on revisions in the tax structure. In addition, I appeared in opposition to H. R. 1 and asked that the Senate Finance Committee give serious consideration to basic revisions in our tax structure. I shall not take the time of the committee today to review in any detail the tax recommendations the CIO made last year. Suffice it to say that we stand by last year's recommendations and feel that they are as basically sound this year as they were then.

In today's testimony I should like to devote most of my allotted time to a discussion of the framework in which tax relief and revision should occur and why the CIO is opposed to the bill H. R. 4700, now being considered by your committee.

The CIO believes that—

(1) Now is the time for proper and adequate tax relief to low-income individuals.

(2) Now is the time also to maintain Federal revenue at a high enough level to cover the necessary expenditures of the Federal Government.

(3) Now is the time to shift some of the burden of taxation from the shoulders of low-income individuals to the excessively high profits of American corporations.

(4) Tax relief now to low-income individuals is not inflationary.

(5) The present bill, H. R. 4700, now being considered by your committee, is only slightly better than last year's H. R. 1, which we described in President Roosevelt's terms that this is "tax relief for the greedy and not the needy."

I should like to discuss now each of these live points in turn.

Now is the time for proper and adequate tax relief to low-income individuals

During the war years personal exemptions for individuals were drastically cut. This widened the tax base and brought in many individuals who never before paid Federal taxes. These exemptions were reduced from a level of \$2,000 for a head of a family and \$800 for a single individual in 1940 to a straight \$500 exemption for each individual. Rates on all brackets were greatly increased. This shift in the tax burden resulted in individuals with incomes of less than \$5,000 paying 100 times as much tax currently as they paid in 1939. In other words, these individuals paid only \$1 million dollars or one-tenth of the total individual income tax in 1939. This year they will pay 11.5 billion dollars, which is over one-half the total individual income tax.

Since the end of the war, no change has been made in exemptions, and individual income taxes have been reduced by only 5 percent. In the past 2 years we have seen the cost of living soar to new heights. According to the Department of Labor, the Consumers' Price Index has increased almost 25 percent in the past 18 months, and it is over 70 percent greater than it was in 1939.

With a great deal of the increased tax burden shifted to low-income individuals, and with these same individuals suffering from rising living costs, we feel that it is essential now to give these individuals adequate and proper tax relief. This should be done by increasing exemptions, not by \$100 as is proposed in H. R. 4700 but by a considerably larger sum. Exemptions for individuals should be \$1,500 a person and \$500 for each dependent.

We estimate that if this provision were enacted into law, it would decrease Federal revenue by approximately 6.5 billion dollars and remove from the tax rolls about 20,000,000 taxpayers. However, we make one further stipulation—that this increased exemption should apply only to those individuals earning less than \$5,000 a year. The precedent for this move rests in the Revenue Act of 1921.

In addition to granting tax relief to low-income individuals through increasing exemptions, serious consideration should be given to excise taxes. Last year we specifically recommended that the wartime increase in excise taxes be eliminated and that as quickly as revenue requirements permitted, all excise taxes, not regulatory in character, be eliminated.

Carrying out these recommendations as they affect the individual means a loss in Federal revenue, but we also believe that—

Now is the time also to maintain Federal revenue at a high enough level to cover the necessary expenditures of the Federal Government

In order to carry through this recommendation, we suggest, as we did last year, that an excess-profits tax upon corporations, along with a form of an undistributed-profits tax, be enacted. For the specific recommendations in this field I make reference only to the statement presented on behalf of the CIO last year to the Senate Finance Committee. We feel that any reduction in revenue resulting from relief to low-income individuals should be compensated for by increased taxation on corporations and eliminating loopholes in other phases of our tax structure, such as capital gains, estate, and gifts, exempt securities, etc.

In periods of high national income and gross national product, it is essential that Federal revenue be sufficient to balance the budget and meet obligations on the public debt.

In periods of low national income it will be necessary to increase Federal expenditures, reduce Federal taxes, and have deficit financing. However, we feel that over a cycle in our economy, the budget should be balanced.

Unless we follow this procedure, our national debt will go even higher than it is today if we run into a serious economic recession.

Now is the time to shift some of the burden of taxation from the shoulders of individuals to the shoulders of American corporations

The shift in our Federal tax structure has been quite drastic in the past 8 years. In fiscal 1940 individual income taxes and taxes upon corporations made up an equal part of the Federal revenue, each contributed about one-fourth of the total receipts. During the war years, a great share of the revenue was borne by both individuals and corporations, that is, in fiscal 1945 individuals paid about two-fifths of the Federal revenue while corporations paid a little over one-third. However, after VJ-day the excess-profits tax was eliminated and individual income taxes were reduced only slightly. As a result, in the coming fiscal year 1946, if no changes are made in our tax structure this year, individuals will pay over one-half of the total revenue while corporations will have their share dropped to less than one-fourth. The share maintained by corporations will be lower relatively than their share in 1940, while the share borne by individuals will be more than doubled.

With this drastic shift in the burden of taxes onto the shoulders of individuals and off the shoulders of corporations, a serious shift in the incidence of taxation has occurred. It is, therefore, with this thought in mind that we recommend that some of the tax burden be shifted from the shoulders of individuals over to the shoulders of corporations.

There are some who argue that a shift in taxes to corporations will destroy incentive and initiative and prevent the adequate development of venture capital. Let me say in this connection that corporate profits in 1929 were 8.5 billion dollars, 12.5 billion dollars in 1946, and 17 billion dollars in 1947—the highest level of profits in our entire history. Corporations were also paying out more in dividends in 1947 than ever before on record, they were retaining more earnings after payments of dividends than ever before on record, they were making larger investments in business and production than ever before on record.

and with their retained earnings paid for a higher share of that investment than ever before on record.

Therefore, I cannot see how the claim can be made that the tax structure will destroy initiative and prevent the free flow of the necessary venture capital.

Tax relief now to low income individuals is no inflationary.

We say that tax relief to low income individuals is not inflationary. Tax relief to low income individuals is essential to enable them to provide themselves with an adequate standard of living.

Tax relief to low income individuals would permit these people to maintain a little better standard of living and would permit them to purchase many of the necessities of life which current income does not permit them to buy. This can be inflationary only if the total supply of goods available is less than what all income levels are demanding. If this is the case, it is far wiser to properly allocate and ration these commodities equitably to individuals of all income levels rather than to deprive the low income individuals of tax relief. In other words, if purchases of the basic necessities of life by low income individuals contribute to inflation, it is not because these individuals' incomes are too high but because the supply of goods available is not enough to go around, or that the supply of goods is being adequately distributed. It is essential therefore that we take steps to see to it that the available supply of goods is equitably distributed amongst all income levels rather than to take steps to prevent adequate tax relief to the low income individuals.

DISCUSSION OF H. R. 4790

I should now like to devote the rest of my time to the discussion of the bill on taxation currently being considered, H. R. 4790, better known as the Knutson bill. This bill is only a slight improvement upon last year's H. R. 1. However, the CIO still maintains the same position that it did last year, and that is the low income individuals are not prepared to accept what little tax relief is granted under this bill as long as such relief is granted at the expense of very substantial relief to the high income individuals.

I should like first to discuss the over-all effect of H. R. 4790. An analysis of the total tax reduction of 6.2 billion dollars which this bill grants shows, beyond a question of a doubt, that the major tax relief is given the wealthy and high-income individuals and only minor relief is given the lower-income individuals. The 26.5 million taxpayers, over one-half of the total who have net incomes of less than \$2,000, receive under this bill a total tax relief of \$1,400,000,000, or 23 percent of the total tax relief. On the other side of the income-tax ladder, 2¼ million taxpayers, who constitute only 4 percent of the total, have net incomes of more than \$5,000 and they receive \$2,100,000,000 in tax relief or over one-third of the total. In other words, 2¼ million well-to-do taxpayers will receive 50 percent more tax relief than the 26.5 million low-income taxpayers. This is neither fair nor equitable.

The over-all effects of this bill are shown for all their worth by a comparison of time tax reduction received by those individuals receiving net incomes of less than \$2,000 as compared to those receiving incomes of \$25,000 or more. 20.5 million taxpayers with net incomes of less than \$2,000 receive, on the average, a tax cut of \$53 a year, the equivalent of a little less than 2.5 cents an hour, if we assume that these workers are fully employed for 52 weeks a year for 40 hours.

On the other hand the 212,000 taxpayers with net incomes of more than \$25,000 a year will receive a tax cut, on the average, of \$4,562 a year or the equivalent of \$2.20 an hour increase, if we make the same assumptions we did with the individuals making \$2,000 a year. In other words those individuals with net incomes of \$25,000 or more get the equivalent of almost 90 times as much increase in their hourly take as the individuals with net incomes of less than \$2,000 a year.

The Knutson bill is grossly discriminatory against the low-income individuals of this country.

I should like to compare the effect this bill would have on the tax obligations of three types of families, each having two children, the first earning \$3,000, the second \$25,000, and the third \$50,000.

The individual head of the family earning \$3,000 a year will get \$110 in tax relief, or 30 cents a day, not even enough to buy the family its daily quota of milk. On the other hand a \$25,000 a year man will receive a tax cut of \$3,822

a year. Here receives a tax cut which is equivalent to what more than 57 percent of our American families earned last year. The \$50,000 a year man will receive a tax cut of \$8,125. This tax cut is equivalent to what more than 93 percent of our American families earned last year.

Clearly and unequivocally H. R. 4700 is a tax steal for the wealthy and a stab in the back for the poor.

I should like to call your attention to the table below which shows the comparison of income after taxes under the present law and under H. R. 4700 for a married individual with two dependents at various income levels. As can be seen from the table, an individual with net income before personal exemptions of \$3,000 has his spendable income increased 3.0 percent while an individual with an income of \$25,000 has his spendable income increased by 20.2 percent. The individual earning \$500,000 a year has his spendable income increased by more than two-thirds.

Comparison of income after tax under present law and H. R. 4700 (married, 2 dependents)

Net income before personal exemption	Spendable income after tax		Percent increase in spendable income
	Present law	H. R. 4700	
\$2,400	\$2,324	\$2,400	3.3
\$3,000	2,810	2,924	3.9
\$5,000	4,411	4,614	4.6
\$7,500	6,134	6,300	5.0
\$10,000	7,878	8,100	5.2
\$25,000	25,880	31,014	20.2
\$50,000	37,699	55,775	47.9
\$100,000	73,075	122,319	67.4
\$500,000	93,400	156,070	67.1
\$1,000,000	161,150	267,035	65.7

Source: Statement of Secretary Snyder before House Ways and Means Committee, Jan. 16, 1948, 3.

It is clear that the CIO is emphatically opposed to H. R. 4700 for the many reasons already stated.

I should like now to refer briefly to each of the major provisions contained in the bill.

First of all the bill increases exemptions from \$500 to \$600 a year. While this is good in itself and would thus remove from the tax rolls over 6,000,000 taxpayers, it is insignificant when related to the basic need.

The second major provision of the bill reduces tax rates by 30 percent on incomes of \$1,000 or less, 20 percent on incomes up to \$4,000 and 10 percent on all others. This is an improvement over last year's approach which started out to have a flat percentage increase for all income levels, and then as it latter emerged, with a graduated 30-, 20-, and 10-percent tax cut, but the 20-percent tax cut affected individuals with incomes up to \$70,000.

In spite of this change, which we do not consider too great an improvement, we maintain our basic position that the most important tax relief to be granted now is to increase the basic exemptions to levels of \$1,500 for each adult and \$500 for each dependent.

If tax rates as such are to be reduced, we think the reduction ought to be not on a percentage basis but on a point basis. This is more consistent with retaining the progressivity of our tax structure.

The third major provision of the bill permits married couples to split their income. This provision was not contained in last year's bill. The Treasury has, since 1921, been recommending to the Congress that the community-property privilege maintained by the community-property States be eliminated. The proposal took the form generally of requiring that families' income be filed in joint returns. This requirement not only closes the loopholes of the community-property States but closes other loopholes existing in the income-tax laws of other States. The inclusion of splitting of income provisions in the present bill is in direct opposition to requiring mandatory joint returns.

This splitting of income provision benefits mainly the middle and high income individuals. Less than 3 percent of the total tax relief derived from this one

provision would go to individuals with incomes of less than \$5,000 while more than 97 percent would go to individuals with incomes of over \$5,000 and 89 percent would go to those with incomes of over \$10,000 a year. For example, this tax splitting proposal gives a married individual earning \$25,000 per year a tax cut of \$3,000 while it gives nothing at all to a man and his family whose total income is only \$3,000. In other words, a married individual earning \$25,000 a year under this income-splitting provision gets tax relief amounting to more than the income earned by approximately three-fifths of the American people. This provision clearly gives relief to the wealthy with absolutely no relief to the low and moderate income individuals.

The CIO strongly urges this committee to recommend that families be required to file mandatory joint returns where the income is earned solely by the head of the family instead of proposing income splitting. The community property privileges now existing in 12 States should be eliminated just as they were eliminated in 1942 for estate- and gift-tax purposes.

It cannot be claimed by anyone that it is unconstitutional to eliminate the community-property privileges from those States now enjoying them, because in this connection the 1942 law which did terminate the community-property privilege for estate purposes has been upheld in the Supreme Court of the United States.

On the floor of the House of Representatives an amendment was proposed and accepted to repeal provisions of the 1942 tax law which eliminated the community-property privilege. We strongly urge this committee not to accept this amendment to the 1942 tax law. We further urge this committee not to adopt the income-splitting provisions which gives all the tax relief to the wealthy.

The adoption of a splitting of income provision would throw our tax structure out of kilter. Splitting of income:

(1) Discriminates against heads of families who are neither married or do not have spouses present in the household.

(2) Discriminates against the low-bracket taxpayer, whether married or not, in all States, as he receives no benefit under this provision.

(3) Discriminates against single individuals who receive no benefit.

The passage of the provision to split incomes would create many discrepancies in our tax structure.

With all of the force and vigor of the CIO we urge this committee to reject not only the income-splitting provision of the Knutson bill, not only the provision repealing the amendment to the 1942 tax law which eliminated the community-property provision, but to reject the Knutson bill as a whole. The Knutson bill, H. R. 4790 is unjust and discriminatory in favor of the wealthy at the expense of the poor. The working people of America will not be deceived by this bill and will not be baited into accepting the scant tax relief this gives them while enormous relief is dished out to those individuals who are best able to pay.

Mr. RUTTENBERG. I should just like to briefly summarize the position we take in this statement.

Before I do, I would like to say I am happy once again to be before your committee and have an opportunity to present the views of the Congress of Industrial Organizations on this all-important matter of taxation.

Last year, when I appeared for the CIO, we presented an extensive tax program for tax revision.

We also, of course, opposed H. R. 1. Those tax recommendations which we made last year, I shall not go into any detail on here today, except to call your attention to last year's record and say that what we had to say on tax revision last year we feel even more strongly on this year.

We stand by what we said last year on long-range tax revision.

In today's testimony, I should just like to make five points.

1. Now is the time for proper and adequate tax relief to low-income individuals.

2. Now is the time also to maintain Federal revenue at a high enough level to cover the necessary expenditures of the Federal Government.

3. Now is the time to shift some of the burden of taxation from the shoulders of low-income individuals to the excessively high profits of American corporations.

4. Tax relief now to low income individuals is not inflationary.

5. H. R. 4790, now being considered by your committee is only slightly better than last year's H. R. 1, which we then described in President Roosevelt's terms that it was "tax relief for the greedy and not for the needy."

Those are the three basic points which I should like to make today.

I think, as Mr. Nixon has so ably pointed out, now is the time for tax relief to low income individuals.

The tax burden which they are bearing today is greater than in all history. Certainly, Federal revenues have increased from a level of 4 and 5 billion dollars in prewar days to the present level of 38 and 39 and 40 billion, and even possibly 45 billion, for the coming fiscal year.

The revenues are highly needed and highly necessary, and we are not proposing before this committee that the amount of Federal revenue be reduced.

On the contrary, we are proposing to this committee that what tax relief results from a reduction in the tax burden on low income individuals be made up for by the imposition of taxes in other fields.

Most specifically, that is an excess-profits tax upon corporations; and (1) a tax which has been discussed before the committee last year; a closing of the loopholes in tax-exempt bonds and capital gains, and (2) closing the loopholes in the estate and gift taxes.

Unfortunately, in that latter category this committee is broadening the loopholes in the estate and gift taxes by the repeal of the 1942 amendment.

I do not want to take up too much time of the committee.

I should just like to direct attention for the time being to the basic question: How to equate tax relief for low-income individuals.

The present exemptions for a family with four is \$2,000.

The exemptions in 1940 for a family of four were considerably higher than that level.

Not only have exemptions in the past 8 years been greatly increased upon low-income individuals, but the tax rates have been greatly increased upon the first bracket tax as well as upon all other bracket taxes.

So that presently over one-half of the total individual income tax is borne by individuals with incomes of less than \$5,000 a year, while in 1939, only one-tenth, or 10 percent of the burden was borne by those individuals.

The major increase in revenue during war years has come from increasing the tax burden upon the low-income individuals. When the war ended following V-J day, the first move made by the Congress was to eliminate the excess profits tax, which also, by the way, was imposed during the war and with an additional burden upon corporations, but little or no relief at that time was given to the low income individuals.

Oh, yes, a 5-percent reduction and elimination of the shift in the method of computing taxes. It amounted to a total change of 5-percent reduction in all income-tax rates.

But, in effect, the major relief at that time was given to corporations through the elimination of the excess-profits tax.

In this past year, the burden as a result of the increased cost of living has been very great upon the low-income individual.

Therefore, we are proposing to this committee that instead of the kind of tax relief as included in the Knutson bill, H. R. 4790, exemptions be increased to a level of \$3,000 for a married couple, \$1,500 for a single individual, and the maintenance of the present exemptions of \$500 for each dependent.

This would reduce the tax revenue by \$6,500,000,000. It would eliminate from the tax rolls some 20,000,000 taxpayers. It would have a great effect upon stimulating a consumption economy as contrasted to the investment economy and venture capital economy which you discussed in some detail with Mr. Nixon.

I should like at this point to direct myself specifically now at the advisability of reducing taxes upon low-income individuals at this time. That is, we would go forth to propose that these increased exemptions apply only to those individuals with incomes of less than \$5,000.

Those with incomes above \$5,000 would continue to maintain the present exemption, of course, with an attached provision to take care of those at \$4,999 and \$5,001 and on up, but exemptions would apply only to the low-income individuals.

That proposal, the reduction in revenue resulting from it, would be compensated for by the imposition of an excess-profits tax similar to the one we had in the war, slightly lower in rate of tax and slightly higher in rate of exemption to give protection to the small-business men and the small corporations of under \$25,000 net income.

You immediately raise the question if you impose a tax upon corporations and do not reduce the tax upon the dividend recipients; that is, the major recipients of dividends and high-income people, if you do that, you destroy all of the initiative to expand capacity in America, to make room for the 700,000 additional workers which come upon the scene each year and you destroy the initiative for individuals in high-income brackets to invest their money in equity capital.

I recall the figures you read into the record, Senator Millikin, on venture capital. They were contained in the report of the House Committee.

I should like to call your attention to the figures in the Federal Reserve bulletin for last month.

The Federal Reserve Board bulletin points up the total equity capital on page 208 of its February bulletin.

It shows that the total stocks and bonds of corporations new capital now, not refunding, excluding refunding, total capital from bonds and stocks in 1947 was \$4,700,000,000.

This is broken down into \$3,500,000,000 for bonds and notes; \$1,200,000,000 for stocks.

This level of \$4,700,000,000 for equity capital, both bonds and stocks, new capital, compares to \$3,500,000,000 in 1946. 1.3 billion in 1945, and there was not another year since 1938, with the exception of 1941, when there was as much as \$1,000,000,000 in new corporate bonds and stocks.

I grant, sir, that between 1946 and 1947 the amount of new capital derived from stock was reduced from \$1,500,000,000 to \$1,200,000,000. Yet the total new capital from bonds and stocks increased from 1946 to 1947 by \$1,200,000,000.

The CHAIRMAN. The progression of the increase was on the bond side, was it not?

Mr. RUTTENBERG. Yes, sir, it was between 1946 and 1947. But, sir, between 1945 and 1946, the progression of the increase was equally great in both the bond and stock side, and in those years, the tax structure was of the same incidence as it is today.

I should like to point out at this point, Senator Millikin, if I may, that in 1947 we had the highest corporate profits on record in American history, and also in 1947 we had the highest dividend payments ever made on record. And also in 1947, corporations retained a greater percentage of their income than ever before on record.

The CHAIRMAN. Why did they do that?

Mr. RUTTENBERG. Why did they do it?

The CHAIRMAN. Yes.

Mr. RUTTENBERG. I should wonder how they were able to in face of section 102 of the Internal Revenue Code.

The CHAIRMAN. Did they not do it for capital expansion?

Mr. RUTTENBERG. They paid for a greater percentage of investment in 1947 out of retained earnings than ever before, which, I think, is a dangerous internal financial development in American economy.

The CHAIRMAN. I am not so sure I would disagree with you.

I think it is dangerous from the standpoint of the stockholder. You are depriving the stockholder of some take-home pay he is making.

Mr. RUTTENBERG. That is precisely the point I am making.

When you pay for expansion out of retained earnings you are not going to the equity market for capital. Therefore, you are not going to the American people and the stockholders for capital but you are retaining the increased capital investment of the corporation in control of a limited number of stockholders in the corporation prior to reinvesting their own money, and that tendency is a tendency toward concentration in American industry.

The CHAIRMAN. I think you will find, before you finish, the testimony will show that the reason for this extraordinary amount of internal financing, you might call it, is because equities were not salable.

I think that will be demonstrated by instances, case after case.

Mr. RUTTENBERG. I think, sir—

The CHAIRMAN. All you have to do is to look at the stock market to see that equities are not salable.

Mr. RUTTENBERG. Right. I agree with you 1,000 percent they are not salable, but I do not agree they are not salable because the tax structure is too high.

I say to you, sir, the reason equity stocks are not salable on the market today is that the current stock market is not reflecting, for some reason or other, which I do not think any of us can answer, the financial earning ability of American industry.

The CHAIRMAN. I suggest to you the stock market today is reflecting the best return per dollar of investment, and I do not know, over what period of time. They are a bargain.

Mr. RUTTENBERG. That is what I am saying, sir.

They are a bargain.

The CHAIRMAN. The reason they are a bargain is because the return from stock in relation to cost of stock is very advantageous. That is the reason.

Mr. RUTTENBERG. You are making my point for me, sir.

What I am saying is: If the stock market was really reflecting the earning ability of American industry, the stock market today would be at higher average price, and as a result, maybe it would encourage more people to come into the market.

Because stocks are low, the people with equity capital who are going to invest are saying to themselves, and as they have ever since the stock market has broken in the last year and a half two or three times, "Something is wrong here. This stock market should be going up, but it is not. Why is it not going up? It must be coming down for some reason or other."

And therein reflects the reason why equity capital is short, not because of the tax structure. Therein lies the reasoning and the attitude of the American people with money to invest in equity markets. They are saying that maybe the future economy of America is not sound enough.

The CHAIRMAN. They might also be saying: "Even though these are selling at a bargain, by the time I take my bargain dividends and apply my tax rates to them, I am not getting any bargain."

Mr. RUTTENBERG. But yet, sir, they are going into the bond market where the yield currently is less than the yield would be in dividends on common and preferred stock.

The CHAIRMAN. It should be, because the risk is less.

Mr. RUTTENBERG. That is right; the risk is less.

But what is happening is that they are yet investing money in the bond market, and they are getting a much lower return only too willingly.

They are getting a lower return, and they also have to pay the same tax on that return which they get on bond income that they would get on dividend income.

The CHAIRMAN. Which makes it clear they do not see enough return for the risk in the equity.

Mr. RUTTENBERG. That is right. I do not argue with you at all.

The only point I am making, and I repeat: It is not the tax structure alone which is preventing equity capital from coming into the market, or preventing new venture capital.

It is fundamentally the basic attitude and position toward the future of our American economy. That is the future of full production and full employment and maximum purchasing power as spelled out in the Employment Act of 1946, and that is why we in labor come before your committee and argue that the way to promote full employment and full production and maximum purchasing power in America is to increase the consumption economy.

I mean, to increase the purchasing power of those individuals who buy the products which industry, through its venture capital, is encouraged to produce.

The CHAIRMAN. You are arguing when you have your full employment, when you have everything, which you were talking about a moment ago, under the ideals of the act to which you refer, that scares people so they get out of the equity market

Mr. RUTTENBERG. If that is the case, sir—

The CHAIRMAN. I am not making your argument. I think it follows from your argument. You say the people have full employment; they have these things, but are scared about the future of the economy.

Mr. RUTTENBERG. But, Senator, I did not go into the kind of detail that would explain my position further, and I am sure you would not attribute your last remarks to my full presentation and understanding of this issue.

One of the reasons they are scared now of the future of our economy is the kind of situation which gives rise to decreasing value of that investing money earnings to the American people as a result of the price structure, and the elimination of the excess-profits tax.

The CHAIRMAN. We are not increasing production rapidly enough to hold up the real purchasing power of the dollar.

Mr. RUTTENBERG. Therefore, I plead with you, as the CIO has before other committees of Congress, the thing to do in this period is to control the price structure so the consumption dollar remains a real dollar and not a fictitious dollar, as the result of rising prices.

The CHAIRMAN. You argue from that the way to increase production is to control it?

Mr. RUTTENBERG. During this interim period, when the supply does not meet the great demand placed on our economy as a result of our domestic and foreign operations, until such time as we expand our capacity to meet the basic need of the American people, unless temporary controls are placed upon that expansion and those prices and allocations, I think, myself, sir, that we are going to fall into the kind of a collapse in our American economy from which we, who look forward to American idealism, may not be able to extricate ourselves short of revolution.

The CHAIRMAN. I suggest you may have that collapse if you reduce production by controls.

Mr. RUTTENBERG. I am not so sure, sir, that the elimination of controls when OPA was scuttled in 1946 increased production in our American economy.

As a matter of fact, I should like to call to your attention, sir, in the shoe industry and the textile industry and in the table-model-radio industry, and the industry producing frozen fruits and vegetables, in February, March, and April of 1947, production was cut, employment was reduced.

Why? In June, July, and August following that period, they took back workers. They increased production, and they were charging higher prices than they were before.

On this particular situation, Business Week Magazine, in its August 7 issue of 1947, says this, and I am paraphrasing now: It was the practice of American industry in the past to reduce price when demand exceeded supply, but evidences of the past few months indicate that industry has reduced production until demand and supply are equated so that we can maintain our high price structure.

So I am not so sure that increasing production, sir, is the solution, unless we have a far more understanding of distributing the share of increased production to the American consumer.

The **CHAIRMAN**. If you can demonstrate that the decrease in production will increase the real purchasing power of your people, you will have accomplished a major miracle in economic demonstration.

Mr. **RUTTENBERG**. Again, sir, I trust you are not attempting to state my position, because, actually, sir, no group in America—and I say this proudly—has been in the forefront of the fight for full employment and full production any more than has the Congress of Industrial Organizations, and we say that with the Marshall plan, and with the need for maintaining our domestic economy, production is vital to our economy.

We say that increasing production is the ultimate goal of our economy.

But we do not kid ourselves into believing that by increasing production the benefits of that increased production will not be retained by the corporations and will be passed on to the consumer.

We, on the other hand, think the benefits of that increased production, as demonstrated in the past 2 years, will be retained in higher corporation earnings and not passed on to the American consumer, and there is the crux of this whole presentation I am making today, sir.

We ought to reduce taxes upon low-income individuals and compensate for the loss in revenue there by increasing the tax upon American corporations.

The **CHAIRMAN**. I go 70 percent along the road with you.

Mr. **RUTTENBERG**. I am glad to hear that, sir.

I am taking more time than I should. I have made the basic points I have in mind.

I should only like to briefly comment upon the shift in the tax burden which has occurred over the last nine fiscal years, and it is with this thought in mind that we also propose a shift in burden of our tax structure.

For example, in fiscal 1940, individuals and corporations each paid about one-fourth of the total Federal revenue which, in that year, was roughly, about \$5,200,000,000, if I recall the figures accurately.

In fiscal 1945, when our revenue was considerably higher, the shift in the tax burden had occurred until two-fifths of the Federal revenue was borne by individuals through individual income taxes, and one-third by corporations, an increase in both categories from the one-fourth that they each bore in fiscal 1940.

However, in fiscal 1949, assuming no change in the present tax structure, individuals will pay 54 percent of the total tax revenue, or over one-half as compared to one-fourth in 1940, while corporations will have their share of the total Federal revenue reduced to a point below the share they paid in fiscal 1940.

I say with that shift in the distribution and burden and incidence of the tax structure we have created a dangerous economic development in America which will affect the consumption economy which people like myself in the labor movement are forever arguing about.

I am not at all saying, Senator, that there is complete agreement amongst economists in America, and particularly amongst classical economists who propose a position which you yourself advocated here this afternoon against the position we advocate which is a high-consumption-level economy as the first basic concern.

The **CHAIRMAN**. You focus your argument more sharply than I do. That is **all**. You would put all of **tile** benefit below \$5,000.

I have an interest in seeing that **the** worker that you want to keep going gets his machines and is **put** into a position to produce, and **that** the fellow who has some money in the business gets a fair return, **He**, in turn, spends that money. **He** has employees. **He** helps to maintain the service industries of this country, makes his contribution to the whole economy.

In other words, the only difference between **us**, if there is **any**, is that **I** think you have got to look at the whole economy and spread the benefits of it **all** along the line.

I do **not** think you can consider **only** consumption economy. I think you have to give some consideration to capital goods.

Mr. RUTTENBERG. I think you are perfectly right.

The CHAIRMAN. These things do not pass off into a vacuum where they remain sterile.

If a corporation makes money, it gives you a chance to ask for more pay. It gives them a chance to expand facilities, and that, in turn, sets **up** productive processes. It gives them a chance to pay dividends. Those dividends are again invested in stocks and bonds for services of all kinds, and it keeps the whole thing going.

If I had any criticism at all of your philosophy, it is that you see only **one** part of the economy, and you see, but you will not give proper weight to, the necessary relationships between all parts of the whole economy.

Mr. RUTTENBERG. I agree that I am concentrating the main brunt of my argument upon a consumption economy, and leaving out of discussion the necessary balance between venture capital and a consumption economy.

But I am **not** unaware, sir, of the conditions and the financial position of **American** corporations today.

I should like to point out that undistributed profits in 1947, the total amount of undistributed profits held by corporations was \$92,000,000,000. The amount of undistributed profits they had accumulated up to 1939 was only \$16,000,000,000. So they have doubled the amount of accumulated undistributed profits not paid out in dividends.

The CHAIRMAN. What have they done with that?

Mr. RUTTENBERG. They have invested some of it back into their plant and equipment. But yet, as Mr. Nixon has pointed out to you the actual cash on hand, combined with Government securities, which are the two main forms of liquid assets, actual available money that is not invested back into the business, in 1947 was \$35,000,000,000 as against \$13,000,000,000 in 1939. They have **not** reinvested that money.

The CHAIRMAN. You noted the figures I gave as to the difference in income between now and 1939. The total net income in this country now is \$132,000,000,000, and in 1939 it was \$15,000,000,000.

Mr. RUTTENBERG. The total net income?

The CHAIRMAN. Yes, sir.

Mr. RUTTENBERG. You mean the total wage-and-salary bill, not the net income? It was over \$200,000,000,000.

The CHAIRMAN. The actual net income.

Mr. RUTTENBERG. Available for taxation?

The CHAIRMAN. Taxable net income.

Mr. RUTTENBERG. I am sorry, sir, I misunderstood you.

The CHAIRMAN. It takes a larger reserve position to maintain \$132,000,000,000 of taxable income than it does to maintain \$15,000,000,000.

Mr. RUTTENBERG. It unquestionably does, sir, but it is at that precise point I should like to say there is a question as to whether the present cash liquid asset reserve position of America is higher than necessary to continue an economy of \$132,000,000,000 of net taxable income.

The CHAIRMAN. I suggest it is not higher than necessary if you have no equity market and must get your expansion out of those reserves.

Mr. RUTTENBERG. I should like to point out, sir, it is not like fair to compare that \$15,000,000,000—is that the figure for 1939?

The CHAIRMAN. The exact figure was \$15,803,000,000.

Mr. RUTTENBERG. To compare it with the \$132,000,000,000 now, because you will realize, sir, in 1939, the exemptions in our personal income tax were such as to reduce the amount of net income available for taxation as against the current day when the exemptions are much, much lower.

The CHAIRMAN. Mr. Stain invites my attention to the fact these figures are before exemption.

Mr. RUTTENBERG. Net income before exemptions?

The CHAIRMAN. Yes.

Mr. RUTTENBERG. If that is true, I would withdraw what I said. I would like to have a chance to check the figures.

I take your word for it, of course.

Senator JOHNSON. May I ask Mr. RutenberG if he finds any necessity at all for expansion in our industrial machine here?

Mr. RUTTENBERG. I think, sir, there is no question but that we need expansion in many areas in our economy.

We ought to increase steel capacity from the present level of 91 million to at least 100 million tons of ingot capacity.

We also must increase the available capacity of natural gas which flows through pipe lines to cities like Detroit, and in order to do that, we need steel capacity.

We need to expand electric and power facilities in this country.

We need all this expansion if we are going to have our eyes set on the ultimate goal of full employment and full production.

Senator JOHNSON. That is what I had in mind.

The other question: How are you going to get this expansion? How are you going to finance it?

Mr. RUTTENBERG. I do not think that the tax structure is standing in the way of that expansion. I do not think that even the officials of the United States Steel Corp., or the American Iron and Steel Institute, who are saying they will not expand capacity more than 2½ million tons in 1949, are saying—and I have never heard it—it is the tax structure which is keeping them from expanding that capacity.

They are saying, on the contrary, sir, the reason they are not expanding steel capacity is they have no hope in the future. They are saying that in the future there will not be as great a need for steel as there is today.

And it is that philosophy which I am challenging here today. It is that philosophy of lack of faith in America's future. If they had faith in the demand for steel in 1952, 1953, or 1954, they would not hesitate today, regardless of the tax structure, to expand capacity, as is

evidenced by the fact they are expanding capacity by \$1,000,000,000 in the coming year, and they are not claiming taxes are keeping them from it. They are doing it. But that is all they think they need to expand capacity in order to meet the demand in future years, and it is not tax structure which is standing in their way.

I grant you, sir, in the future, it may be necessary in a period of deflation and in periods of declining national income, to reduce the taxes upon high-income individuals. I do not think there is any question that it may become necessary as we go on in future years, but I do not think that reduction of taxes upon high-income individuals today will have one scintilla of effect on the expending capacity in America or venture capital.

The CHAIRMAN: Mr. Ruttenberg, for your information, those figures I gave you on taxable income will be found on page 41 of the hearings before the House, and they are taken out of a table supplied by the Treasury.

Mr. RUTTENBERG: I do not mean to imply that I was questioning the figure. If I did imply that, I certainly did not mean to.

The CHAIRMAN: I think there ought to be a line of distinction as to the argument you have made as to why steel does not expand, and the whole field of new ventures.

These long-established, let us call them "blue chip," companies have far less difficulty in financing themselves than do new and smaller companies. There is the field I suggest where the pinch on equity capital is most severe and does considerable harm.

Mr. RUTTENBERG: Without having sufficient evidence to justify my statement, I should just like to enter this consideration for you.

Maybe the antitrust suit recently brought by the Department of Justice against companies, which float bonds and stocks on the market, has something to do with why small corporations cannot get the necessary equity capital that some of them are striving to get.

When an outfit like Kaiser-Frazer cannot get an important Wall Street house, or an important La Salle Street house, to float its securities, maybe the reason that it cannot has something to do with the availability of equity capital.

I say the Department of Justice is now in the process of investigating that kind of a situation. What they will find, I do not know; but I think that has to also enter the picture.

What I am saying, sir, is that the tax structure itself is not the sole thing; just as I would say increasing exemption is not the sole way to promote consumption economy in America. I think the way to do that is to increase wages.

The CHAIRMAN: I do not think anyone would say it is the sole reason, Mr. Ruttenberg. But the argument comes over the degree of relevancy.

Let me ask you before you finish. You stated when you were listing your points you were going to tell us that giving relief to lower brackets would not increase inflation.

I hope you do not fail to give us your argument on that.

Mr. RUTTENBERG: I should like to present my general approach on this.

However, before I do, let me say whatever arguments your committee, or Mr. Knutson's committee in the House, offers for justification for its tax bill, would fit the picture here.

The CHAIRMAN. *Nr.* I hope to buttress those arguments with your own.
Mr. RUTTENBERG. My section in my statement is very brief. Let me read it to you.

The CHAIRMAN. Do not make it brief; make it strong.

Mr. RUTTENBERG. I would like to enlarge upon it, but maybe by reading this brief statement I can elicit from you questions which will make it stronger, our argument in justification for our joint position.

We say that tax relief to low-income individuals is not inflationary. Tax relief to low-income individuals is essential to enable them to provide themselves with an adequate standard of living.

Tax relief to low-income individuals would permit these people to maintain a little better standard of living and would permit them to purchase many of the necessities of life which current income does not permit them to buy.

This can be inflationary only if the total supply of goods available is less than what all income levels are demanding. If this is the case, it is far wiser to properly allocate and ration these commodities equitably to individuals of all income levels rather than to deprive the low-income individuals of tax relief.

In other words, if purchases of the basic necessities of life by low-income individuals contributes to inflation, it is not because these individuals' incomes are too high, but because the supply of goods available is not enough to go around, or that the supply of goods is being inadequately distributed.

It is essential, therefore, that we take steps to see to it that the available supply of goods is equitably distributed amongst all income levels rather than to take steps to prevent adequate tax relief to the low-income individuals.

The CHAIRMAN. Even if we do not go for your rationing plan, you would still favor relief to the lower brackets?

Mr. RUTTENBERG. I would, sir; certainly.

If I may, I would like to discuss the point further which makes clear the point of view I have in the matter.

I should just like to address myself to the one question which you have raised, Senator Millikin, and that is 70 percent of this tax relief goes to those with incomes of less than \$5,000 and 30 percent goes to those with above \$5,000.

This bill, H. R. 4790, give tax relief to 26,500,000 taxpayers with net incomes of less than \$2,000.

These 26,500,000 taxpayers are one-half of the total paying taxes today. They receive only 23 percent of the tax relief.

That is, the group with net incomes of less than \$2,000 receive 23 percent of the total tax relief.

The CHAIRMAN. What part of the whole tax do they pay?

Mr. RUTTENBERG. What part of the whole tax?

The CHAIRMAN. Of the \$21,000,000,000 we collect, what percentage do they pay?

Mr. RUTTENBERG. Those of less than \$2,000—I do not have the figures at hand, but I should imagine it is about 30 percent, because it is 53 percent for all those with less than \$5,000. About 30 percent.

They got a cut of 23 percent.

On the other side of the income tax ladder there are $2\frac{1}{4}$ million taxpayers with incomes of more than \$5,000. That is about 4 percent of the total number of taxpayers, and they receive over one-third of the tax relief.

I am using the figures that the Secretary of the Treasury has introduced into the record of both the House committee and the Senate committee. They differ, however, from the figures presented by the House Ways and Means Committee and the joint tax staff.

The CHAIRMAN. So that about 2,000,000 of those taxpayers pay what percentage of tax, Mr. Starn?

Mr. RUTTENBERG. They paid 9.7 billion out of 21.2 billion.

The CHAIRMAN. So the 52,000,000 pay the difference between the figure that you have just mentioned and the total of, say, \$21,000,000?

Mr. RUTTENBERG. That is right.

The point I want to make, sir, is this: It has to do with the question you addressed to Mr. Nixon, and I recall you addressed it to both Mr. Nixon and myself last year, over which we had considerable amount of jesting, but yet serious answers.

Twenty-six million, five-hundred thousand taxpayers with net incomes of less than \$2,000 receive, on the average, a tax cut of \$53 a year, the equivalent of a little less than 2.5 cents an hour, if we assume that these workers are fully employed for 52 weeks a year for 40 hours, or 2,800 hours. They will get a 2.5-cent wage increase, while the taxpayers earning more than \$5,000 a year net income, of which there are 212,000—which is not very many compared to the 52,000,000 that pay taxes—under this bill will receive a tax relief of \$2.20 an hour, 90 times greater than the increase received by those with incomes of less than \$2,000.

I say, sir, if we are going to give tax relief to the high-income individuals, let us give it to them, but let us not give that to them at the rates permitted under this bill.

While the tax cut is only 10 percent for those individuals with taxable income of more than \$4,000, as in H. R. 4790, that 10 percent on the tax load carried by the high-income individual is considerably more than the 30 percent tax cut given to those individuals with taxable income less than \$1,200.

While you might say it is 30 and 20 and 10 percent cut, in effect a 10 percent cut on a tax bill of a man having only \$90 tax is considerably lower than 10 percent tax cut on a man having a tax bill of \$15,000, and that is the issue involved here.

I should like to very quickly—and it is very good of the committee to give me this time—

The CHAIRMAN. It is always a pleasure to hear from you.

Mr. RUTTENBERG. I should just want briefly to say on the community-property provisions of the law that I feel again what has happened here is that the major relief is given to those individuals who are most able to pay high taxes, with little or no relief given to those individuals less able to pay.

I need not point out to you again, sir—and it has no doubt been pointed out many times—the splitting-of-income provision in this bill which reduces Federal revenue by \$803,000,000 gives 97 $\frac{1}{2}$ percent of that to individuals above \$5,000, gives only 2.5 percent to those below \$5,000.

Senator JOHNSON. The question is: Is it just?

Mr. RUTTENBERG. No, sir.

Senator JOHNSON. We ought to determine it on the basis of whether it is right or whether it is wrong.

Mr. RUTTENBERG. I say, sir, it is wrong to give to 36 States what 12 States now have just because 12 States happen to have the provision now.

Senator JOHNSON. How can you take it away from the 12? You cannot take it away from the 12; we have tried that.

Mr. RUTTENBERG. The 1912 tax amendment which deals with the estate and gift-tax provisions has been upheld by the Supreme Court of the United States. Its constitutionality has been upheld. It is perfectly constitutional for the Congress to pass a law to take away the community-property privileges of those 12 States, and at that time it was only 8 States. The Supreme Court has upheld it.

The basic question which this committee is faced with is, there are so many complications involved in taking away from the 12 States. Let us forget about those complications and let us give it to all 48 States.

Senator JOHNSON. You have got to do one or the other.

Mr. RUTTENBERG. That is right, and I think it is far more equitable, far more just, far more reasonable, to take it away from the 12 than it is to give to the 36, particularly when the major tax relief goes to those individuals with incomes of more than \$5,000 a year, and actually 87 percent of the tax relief goes to those individuals with incomes of more than \$10,000 a year.

I say that is the issue there.

The CHAIRMAN. How many working women have you on your working force now?

Mr. RUTTENBERG. About 25 percent of the total workers are women, roughly.

The CHAIRMAN. The women are great income producers now; are they not?

Mr. RUTTENBERG. Great income producers, yes, sir.

The CHAIRMAN. Do you oppose the economic independence which they have?

Mr. RUTTENBERG. Not at all.

The CHAIRMAN. Would you deprive them of the privilege of carrying their own weight as far as taxes are concerned if they wish to?

Mr. RUTTENBERG. Not at all. We would propose, if you have a mandatory joint return, provision should be made where income personally earned—that is, earned income—individual returns are permitted. Where income is not earned but transferred for tax purposes, it ought to be on the joint return.

The CHAIRMAN. In the community States, you would compel uniformity by compelling joint returns—in the community-property States?

Mr. RUTTENBERG. Where the income is earned by one of the spouses.

The CHAIRMAN. Despite the fact they operate on an entirely different system than the common-law States?

Mr. RUTTENBERG. Yes.

The CHAIRMAN. The ownership of the husband and wife in that community property, I suggest, is not a fancy. If you believe it is, just watch what happens when there is a divorce or death.

In other words, for the benefit of splitting that income, they have to assume some burdens.

Mr. RUTTENBERG. That is right.

The CHAIRMAN. You would deny them the benefit that flows from the split and fasten the burden on them?

Mr. RUTTENBERG. Put the argument in reverse, sir. You are doing just that thing for the 36 States—giving them a benefit without assuming the responsibilities of community law.

The CHAIRMAN. That is entirely right.

Mr. RUTTENBERG. Is that fair and equitable and just?

The CHAIRMAN. You are entirely right. We are talking about equalizing. If you start to impose the joint return on community-property States, you are not equalizing and are not doing justice. You reverse that and say by giving the rest of the States the right to split when they do not assume the burden of community-property States, that is an injustice.

I suggest the rapid extension of the community-property States makes this more or less of a theory, and I believe the Federal Government can take a practical look at it and say, "Let's get this done."

Mr. RUTTENBERG. I am sorry to see the tradition of Congress in considering this thing ever since 1921 is now being reversed.

Since 1921, the Congress has been considering the problem of requiring mandatory joint returns, and in various revenue acts have attempted to do it.

As a matter of fact, in 1942 they tried to do it and lost by 1 vote in the committee. If I am not mistaken, Senator George, you were chairman of the committee then.

Senator GEORGE. It was a very close vote.

Mr. RUTTENBERG. I say the tradition is being changed now, and why is it being changed at this point? The change means tax relief to the high-income individuals who are most able to pay.

I say it is unfortunate the shift has been made in that regard.

The CHAIRMAN. Do you mind if I put something in the record here about the justice of this thing?

Mr. RUTTENBERG. Certainly.

The CHAIRMAN. Let us test the relation of income taxes paid per dollar of income by taxpayers in different brackets.

I am talking about a single person with no dependents, with net income before exemption.

The \$5,000-income man pays 10 times as much as the \$1,000.

The \$10,000-income man pays 25 times as much as the \$1,000 man.

The \$20,000 income man pays 70 times as much as the \$1,000 man.

The \$25,000 man pays 99 times as much as the \$1,000 man.

The \$50,000 man pays 265 times as much as the \$1,000 man.

The \$100,000 man pays 669 times as much as the \$1,000 man.

Let us make a shift and relate it to the \$5,000 man against the upper bracket.

The \$10,000 man pays 3 times as much as the \$5,000 man.

The \$20,000 man pays 7 times as much as the \$5,000 man.

The \$25,000 man pays 10 times as much as the \$5,000 man.

The \$50,000 man pays 27 times as much as the \$5,000 man.

The \$100,000 man pays 69 times as much as the \$5,000 man.

Does that not raise certain questions of fairness in your mind?

Mr. RUTTENBERG. It raises only one question in my mind and that is as to the **progressivity** of our tax structure.

I think when Congress originally adopted the individual income taxes they did it on the progressive theory—that those most able to pay should pay.

The CHAIRMAN. That is the result, and it is a very sharp, harsh result is it not? heart does not bleed the many individ-

uals in America who have the kind of incomes that pay 669 times what the man earning \$1,000 pays.

The CHAIRMAN. In a word, you think that is fair—what I have read to you?

Mr. RUTTENBERG. I think it is, sir.

I should like to enter into the committee's concern just three points on the splitting of income.

The splitting of income—

1. Discriminates against heads of families who are either unmarried or do not have spouses present in the household;

2. Discriminates against the low-bracket taxpayer whether married or not, in all States, as he receives no benefit under this provision.

3. Discriminates against single individuals who receive no benefit.

What, in effect, splitting of income provision does is to have a separate kind of tax structure for married individuals, another kind for single individuals, and another kind of tax structure for those married individuals whose wives die and they have another individual in tile household.

I say that is not fair. I say if you want to extend community-property privileges to all States in the United States, it ought to be done in such a way—I do not say it should be done—if you do it, to take into consideration that these individuals receive no benefit.

Senator **GEORGE.** You are right about that, but would we not be making a good deal of progress if we got the equality of it from between the States, then tried to remedy it as to the individuals?

We have to take one step at a time, and I have been very much interested in what you are saying, but under this bill which you do not like there would be 6.5 million taxpayers in the very low brackets, who would be entirely relieved of any taxes. Then under the increase in exemptions for the aged taxpayer's, there would be 1,400,000, very close to 8,000,000 taxpayers who would be relieved entirely.

Do you not think that is worth starting on? Do you not think that adds something to the purchasing power of those groups?

Mr. RUTTENBERG. I think it does, unquestionably, sir, but I think it is a principled matter at this point, whether the low-income individual should accept tax relief at the expense of seeing tremendous relief to those in high brackets who at this precise moment should not be receiving it.

Senator **GEORGE.** That is not all. Above those entirely exempted, there is some relief that goes to the low-income taxpayers. It might not be in the proportion you wish to do it, but if any relief is to be given to those above outside of the split-income provision, which I regard really as an effort to iron out an inequity, and which for a long time I had hoped to iron out the other way around—but we had no chance of getting it, of doing away with the community property as

a basis of taxation simply by saying that for Federal tax purposes all of it should be considered as being earned by the earner whoever he was.

Mr. RUTTENBERG. I wish you were still continuing to fight for that, Senator GEORGE. Well, we lost that fight.

Mr. RUTTENBERG. And you put up an able one.

Senator GEORGE. Now, the question is whether we can iron out this inequality between the States which has become so acute in the instance of a State, for instance, joined on three sides by noncommon law, or community-property States. It is a pretty bad case.

Mr. RUTTENBERG. Arkansas is in bad shape.

Senator GEORGE. Arkansas is that particular State. It is faced on three fronts by the community-property States and it is a very great burden. It is a very great immediate direct burden on its citizens.

Of course, the same burden is on people down in my State, or some other remote State, but they do not feel it so much because they are not adjacent to a community-property State.

I think that we ought to look at this bill as an effort to try to iron out that inequity, although we may not be doing it in the very best way, because admittedly our tax rates are high now and will be high after this bill.

I agree with you this bill will not add a lot of cash reserves that will go into equity financing, if that is due, or influenced even in part by our tax structure, because we are not going to give them so much. These fellows in the higher brackets will not have so much when it is all over.

Mr. RUTTENBERG. They will have a little.

Senator GEORGE. That is right, they will have a little.

Mr. RUTTENBERG. I do not say that, you will take Senator Millikin's argument away from him.

Senator GEORGE. Senator Millikin, as well as anybody, knows this bill is simply a step, and a pretty feeble step, possibly, toward getting very much money into places where you can replenish your investment in these things that must be carried on in this country.

I know you have studied the history of England. Of course, there were plenty of reasons why England did not make investments in her plants and did not keep them modernized.

She had the wars and had everything else. She had more than we had, I mean, but after all, England did not do it.

While England has managed to keep an hourly wage fairly high, production so fell off and conditions were so tough there they were not able to keep their plant, their machine going and operating.

I might be mistaken, but we have to approach these things as best we can to see if we cannot really do something in the right direction in this bill.

I think you would agree that there would be some benefit coming even to the low taxpayers.

Mr. RUTTENBERG. Yes; there will, certainly.

Senator GEORGE. I appreciate your position that we are paying too high a price for that and ought not to do it, but I think you would agree there will be some benefits coming to the low income group, the low taxpayers, the lowest taxpayers, certainly, who are in the greatest need.

Mr. **RUTTENBERG**. I call only say this, sir. I just got back last evening from Minneapolis where I attended an education conference of the Textile Workers Union. There were over 400 people at that meeting, and I presented to them this one question, just this question of this bill, and I tried to present it as objectively and impartially as I could, as to the amount of relief it gives to low income individuals as against high-income individuals.

The overwhelming majority of those people who would receive some benefits under this bill said to me that the position which I was taking was sound. "We agree with it. We do not want to accept minor relief if we get it at the expense of the kind of relief given to other individuals."

The **CHAIRMAN**. Then, is it your position, if we did not accept your theory of a bill, that a bill following the structure of the Knutson bill, reduced in amount but preserving roughly the distribution between lower and higher incomes, were advanced, you would rather not have that?

Mr. **RUTTENBERG**. That, sir, is my general position. It is a difficult one to take and one mainly based upon principle.

The **CHAIRMAN**. For our guidance, is it your theory or not?

Mr. **RUTTENBERG**. I would prefer not to answer the question that way, sir. We had that argument last year. I answered in the negative last year.

The **CHAIRMAN**. Mr. Nixon has said the need of your people is greater at this time than it was a year ago.

Therefore, the merit of giving them 70 percent rather than nothing is 70 times better than nothing, and I hoped you would reluctantly say you would rather have that than nothing.

Mr. **RUTTENBERG**. I say again it is a matter of principle. I have enjoyed very much being here.

The **CHAIRMAN**. Thank you for coming, Mr. Ruttenberg. We are always pleased to have you.

We will recess until 10 o'clock tomorrow morning.

(Whereupon, at 4:45 p. m., the committee recessed until Tuesday, March 9, 1948, at 10 a. n.)

REDUCTION OF INDIVIDUAL INCOME TAXES

TUESDAY, MARCH 9, 1948

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

The committee met at 10 a. m., pursuant to adjournment, in room 312 of the Senate Office Building, Senator Eugene D. Millikin (chairman of the committee) presiding.

Present: Senators **Millikin** (chairman of the committee), Hawkes, George, Byrd, and **Lucas**.

The **CHAIRMAN**. The hearing will come to order.

Mr. Secretary, we are glad to have you here this morning. Will you proceed in your **own way**?

STATEMENT OF W. AVERELL HARRIMAN, SECRETARY OF COMMERCE, ACCOMPANIED BY MICHAEL J. MEEHAN, DIRECTOR, OFFICE OF BUSINESS ECONOMICS; S. MORRIS LIVINGSTON, CHIEF, NATIONAL ECONOMICS **DIVISION**; IRWIN FRIEND, CHIEF, BUSINESS STRUCTURE DIVISION, DEPARTMENT OF COMMERCE, **WASHINGTON, D. C.**

Secretary **HARRIMAN**. Thank you, Mr. Chairman.

I have a paper which I have prepared that I should like to present to you if I may.

The **CHAIRMAN**. You may proceed.

Secretary **HARRIMAN**. Mr. Chairman and members of the committee, in response to your invitation I shall review for the committee some of the economic aspects of the fiscal proposals pending before the Congress at this time. I shall do this from the standpoint of the relationship of tax proposals to the general economic situation with particular attention to the capital markets, being guided to some extent by my earlier discussion of this subject before the Ways and Means Committee of the House of Representatives. I shall **not** discuss the details of particular revenue proposals which this committee has under consideration, since these have already been reviewed by the Treasury officials who are responsible for the administration of the national finances.

First, I shall review the **current** economic situation and present an analysis of the reasons why **Government** revenues should be maintained at this time. Secondly, I shall go over in some detail the current level of capital expenditures by business and the sources from which **these** outlays have been financed, so that the committee may have the benefit of our latest facts on this significant aspect of the functioning of our economy.

Our present position is not only one of full employment and peak business activity. The aggregate effective demand for goods and services has been sufficiently in excess of the total supply that can be made available at this time to exert strong inflationary pressures.

As the result of these inflationary pressures prices have moved up markedly. Although the physical volume of output has risen appreciably in the last 2 years, price rises have been the major element accounting for the increase in the gross national product, which is the current dollar value of the total output of goods and services.

It is true that the readjustment of grain prices to improved crop conditions resulted in some general weakness in farm products and foods in February. Even in this area, however, the February decline of 3 to 4 percent in the index of retail food prices left that index higher than at any time prior to last September. The decline in the combined index of consumer prices must have been even less, bringing it to about the level of last November. Many prices are still rising, reflecting the excess of demand over supply in these segments. The Bureau of Labor Statistics' index of wholesale prices of all commodities other than farm products and foods for the week ending February 28 was above the year-end level.

Three of the four major segments of the national product—all except Government—rose to new highs in 1947. This is indicative of the fact that there is unprecedented private demand for consumption goods and for capital goods as well as an unprecedented volume of exports. The general trend over the period from 1929, and the quarterly changes in 1946 and 1947, are presented in table 1.

I have presented a table, sir, on page 3 of my statement. This shows the gross national product and the manner in which it is divided.

(The tables will be found beginning on p. 435.)

You will see that gross national product for 1947 is 229.6 billion and personal consumption expenditures were 164.4 billion. Nonfarm plant and equipment expenditures were about 20 billion, others about 8 billion.

Net foreign investment was 8.7 billion and Government purchases of goods and services were 28.7 billion.

You will see the comparisons for the different years.

The CHAIRMAN. Do you have any present estimates as to our national income for either calendar 1948 or fiscal 1949?

Secretary **HARRIMAN.** No, we have not. We do not attempt in the Department of Commerce to project what the future will hold. We are a reporting agency and fortunately we have not the responsibility, which I realize this committee has, of making forecasts.

You will see, of course, that the fourth quarter of 1947 was substantially higher than the average for the year.

Table 2 on page 5 shows these major segments as percentages of the gross national product. The combined share going to private domestic investment, to foreign investment and to government is larger than in any of the prewar years. This increase in the share of the national output as well as in absolute terms is a heritage of the war—the backlog of deferred replacements and expansion of our productive facilities, the critical needs for rehabilitation and recovery abroad, and the continuing costs of our own war effort.

The share available to consumers has been correspondingly limited. **It** is a smaller percentage of the total than in any year prior to 1941. **The** physical volume of goods available to consumers **is**, of course, well above the best prewar year. The limits of our materials, **manpower**, and other resources, and **the** other demands upon **our** productive capacity have not **however**, permitted an increase in **the** physical **volume** of goods available to consumers anywhere near in line with the increase in their dollar income.

Let me hesitate a moment on table 2, if I may, Mr. Chairman.

The CHAIRMAN. Surely.

Secretary **HARRIMAN.** You will **see** that personal consumption **expenditure** **is** 71.6 percent of our gross product in 1947, whereas when you go back to **the** earlier years before 1940, they ranged between 84 down to 74, the 84 being, of **course**, the depression year of 1932.

Nonfarm plant and equipment in this year of very high production **was** 8.7, which is higher than any year except **1929**, and is higher than the years prior to 1929 which **are** not shown in this table.

The CHAIRMAN. What, Mr. Secretary, makes **up** your column: "**Government** purchases of goods and **services**"? What is included and excluded in **that**?

Secretary **HARRIMAN.** That is all of the expenditures of the **Government** on a percentage basis. That includes any kind of expenditure the Government makes, including expenditures for gifts that are sent abroad.

There is nothing left out, is there, Mr. **Meehan**?

Mr. MEEHAN. None of goods and services are omitted.

Secretary **HARRIMAN.** That is the total. That shows the **Government** is spending 12.5. **Our** net foreign investment is **3.8**.

Personal income, as shown in table 3 on page 6, amounted to **\$197,000,000,000** in 1947 compared with **\$73,000,000,000** in 1939. Even with personal taxes taking 11 percent of the 1947 income compared with only 3 percent of **the** 1939 **income**, the disposable income after taxes was about **2.2** times the 1939 figure.

The CHAIRMAN. **If I** may interrupt, with reference to your **statement**:

the disposable income after taxes **was** about 2 times the **1930** figure—is that in dollars or **percentage**?

Secretary **HARRIMAN.** That is in dollars.

The CHAIRMAN. **Not** in **percentages**?

Secretary **HARRIMAN.** No, that is in dollars.

Have we the figure in actual goods with us, Mr. **Meehan**?

Mr. MEEHAN. **No.**

Secretary **HARRIMAN.** The willingness and ability of consumers to spend a substantially larger share of their income than they did during the war has been **one of the major** expansionary forces of the last 2 years. These **expenditures—and** the resulting **increases in** prices in the face of the limited supply of consumer **goods—would** have been even larger if tax payments were not well above the prewar rate.

You will see that personal incomes, **10.9** percent were taxes; **83.6** percent were consumption expenditures; and **5.5** percent were savings.

During the war, you will notice the savings were naturally very much higher because the people did not have the goods to **buy**. Then

in prewar years you call follow through on the table the percentage variation of savings from year to year.

The **CHAIRMAN**. Mr. Secretary, I am interested in your statement:

These expenditures—and the resulting increases in prices in the face of the limited supply of consumers' goods—would have been even larger if tax payments were not well above the prewar rate.

Except as tax payments are used for reduction of debt, what distinction do you draw between private and public spending?

Secretary **HARRIMAN**. All spending adds to inflationary pressures, and I am referring here to the debt retirement as deflationary as against being made available through personal incomes for people to spend.

The **CHAIRMAN**. That would depend, I believe you will agree, on how the debt retirement is made?

Secretary **HARRIMAN**. To some extent.

The **CHAIRMAN**. If you buy a bond from the citizen, you are putting that much in the bank which he may spend.

Secretary **HARRIMAN**. That is correct.

The **CHAIRMAN**. And if you buy a bond from the Federal Reserve, you may be contracting credit.

Secretary **HARRIMAN**. That is right.

The **CHAIRMAN**. But, is it not possible the expenditures might have been less had there been less Government expenditure?

Secretary **HARRIMAN**. Of course, all Government expenditures, as well as all private expenditures, add to the inflationary pressures.

Government expenditures, by and large, have an effect similar to private expenditures.

The **CHAIRMAN**. Coming back again to that sentence:

These expenditures—and the resulting increases in prices in the face of the limited supply of consumers' goods—would have been even larger if tax payments were not well above the prewar rate—

I repeat that except to the extent that those tax payments have been used for retirement of debt in ways that contract credit, is it not possible had the money remained in the hands of the people, or some part of it, there would have been less proportionate spending?

Secretary **HARRIMAN**. This statement relates purely to the consumer end. It is our opinion that, if the consumer had had more money, he would have gone to the markets and bid for more goods. That seems to be the character of the market at the present time, and it does not, of course, relate to the other side of what Government does with the income which it receives from taxes.

The **CHAIRMAN**. It seems to me that what the Government does with its income falls in several broad categories. It pays a considerable part of it out for wages which have the same effect precisely as far as inflation or deflation is concerned as wages on the private pay rolls.

Secretary **HARRIMAN**. Exactly.

The **CHAIRMAN**. It also uses a considerable part of the money for projects which involve scarce materials.

Secretary **HARRIMAN**. That is correct.

The **CHAIRMAN**. Steel and other things.

I do not quite see the demonstration of your statement that the inflation would have been greater had the Government not taken the taxes from the people represented by the present tax rate.

Secretary HARRIMAN. This is part of my argument, sir, and this only relates to the question of what would have happened if the consumer had had more money.

I fully recognize that Government expenditures are equally inflationary with other types of expenditures in similar categories, and I am not dodging that at all. I am only discussing what would have happened if the consumer had had greater income at this time. It is leading to the argument that Government income should not be reduced, in my judgment, at this time, and the surplus should be used for debt retirement.

Senator GEORGE. Mr. Harriman, are not Government expenditures more inflationary?

Mr. HARRIMAN. No; I would think they would be exactly similar to private expenditures in the same category.

Senator GEORGE. In the same category, but you have a different sort of an operator.

Call you not see that they are more inflationary in your commodity markets? Has it not been so for months?

Secretary HARRIMAN. The volume of Government purchases in certain areas have added to the prices.

Senator GEORGE. I am not speaking of the volume. I am identifying the operator in your market, and when the Government gets into your commodity market, you see what happens. You see it every day.

Secretary HARRIMAN. I would think that by and large it is generally the volume of purchases that affects prices rather than who buys.

Senator GEORGE. I would think, by and large, they would ultimately do it, but I cannot escape the conviction myself that when Government goes into business on a large scale, as in your commodity markets, your inflationary influence is definitely greater than if it was just simply left to your private trading.

Secretary HARRIMAN. Senator, I would not have thought so. There are two cases which I would like to distinguish.

One is grain, where the Government has been a very large buyer for shipment abroad.

But take meat, where the Government has not been involved in most of the categories of meat, and your meat prices have been the most troublesome of all.

Senator GEORGE. They have, but the minute you moved the grain up, you moved your meat prices.

Secretary HARRIMAN. It has been the demand for meat, sir, which, in my judgment, has affected the prices of meat.

Senator GEORGE. The demand for it, but also the scarcity of grains and high prices of grains, which very definitely affect the meat prices from your local farm community up.

Secretary HARRIMAN. Your lack of corn has, to some extent, affected this year's volume of certain categories of meat, but it is the demand that makes the price of meat.

Senator GEORGE. It is the demand?

Secretary HARRIMAN. If people did not buy the meat, and there was a surplus of meat, regardless of what it cost to produce, your meat prices would go down. It is not the cost of production, it is the demand, in my judgment, which has caused the meat price rise.

The CHAIRMAN. You would not contend, Mr. Harriman, the cost of producing the meat has no relation to the price?

Secretary **HARRIMAN**. Your profit in meat production is very high, as I understand it, at the present time, and it is not the cost but the demand which has created the high price on meat.

The **CHAIRMAN**. I suggest that in the field of feeder operations, for example, the price is almost entirely controlled by the cost of grain. I think that is in line with what Senator George has said, that all of these grains are interchangeable. If the price of corn does not permit, the γ will feed wheat.

Secretary **HARRIMAN**. But demand during the current inflationary period fixes the price rather than your cost.

The **CHAIRMAN**. I would not waive demand out of there as of no consequence, but I think the whole thing forms a complex in which you cannot eliminate any one of the important elements, including the cost of your feed.

Coming back, Mr. Secretary to the inflationary effects of Government spending, or whatever effect you wish to attribute to it, if you distribute the tax reduction to the lower income brackets and thus have more consuming power, it is perfectly apparent that those consumers out of their individual resources could not go into the grain market and buy 50 or 100 million bushels of grain at a crack and give advance notice they were going to do it, and thus raise the price.

It is perfectly apparent, I suggest, that those individual beneficiaries of that kind of a reduction could not go out and buy vast amounts of steel, vast quantities of cement, vast quantities of lumber and piping and plumbing materials, and so forth, and so on, in sufficient quantities as to have a very decisive effect on prices.

Will you not agree with that?

Secretary **HARRIMAN**. I think it is always difficult for the Government to buy in large amounts, but it is my judgment it is the over-all volume of purchases which affects your price. There is no doubt that the Government purchases of grain have affected the price of grain.

Of course, the question naturally back of it is the question of need, and it has been our national policy to attempt to take care of the very grave needs abroad, not only in Europe, but in other parts of the world, where there is suffering and where they have food shortages. This situation has led to the policy of buying large quantities of grain for human consumption abroad rather than leave γ it here available for animal consumption.

But, may I say that the effect of that has been inflationary. There is no question about it.

The **CHAIRMAN**. Do you think that our control of exports in the past has been as sensible as it might have been, having inflation in mind?

Secretary **HARRIMAN**. The Department of Commerce, of course, is charged with the fundamental responsibility. Its decisions are made after consultation with all other departments affected. The final judgment has been based upon the relative needs at home and in support of our foreign policy not only in Europe but in South America and other parts of the world.

The judgment has been an attempt to balance our domestic needs with what is considered our obligations and responsibilities abroad.

The CHAIRMAN. This is not an inquisition into your policies on export controls in the past, but I think the general consensus of opinion in Congress is that in the past they have not been handled as well as they might have been if the desire was to hold down inflation.

Secretary HARRIMAN. That is a matter of opinion, sir, and I may say this: The regulation of exports is one of the most difficult matters with which I have ever had anything to do, and it is very difficult to satisfy everyone in connection with the exercise of judgment.

I simply wanted to say that those judgments have been made after consultation with all of the Government departments and agencies involved through staff committees and through higher-level Cabinet committees.

The CHAIRMAN. We recently had evidence put on the Senate floor, I think, consisting of material supplied by your department of very scarce materials that have been sent to Russia under our export program.

Secretary HARRIMAN. May I say this: With the disposition of tile country and the Congress limiting the amount of money available to the Department, until recently we were controlling I think only about 25 percent of our exports. That is all the staff we had to handle such matters.

Since that time, Congress has given us more money, and we are controlling a larger percentage of our exports.

At that time, there was, except for petroleum products, no control on shipments to Russia except on basic commodities like steel. Tile machinery, for instance, was entirely open to foreign purchases in this country.

At the present time, that is going under control, and we are controlling those shipments, not only to Russia but other European countries.

The CHAIRMAN. The record made in the Senate indicated that much machinery which has been sent to Russia came out of very scarce markets.

Secretary HARRIMAN. May I say this: That those purchases were made by the foreign buyer in our markets here, and that some of the commodities were scarce and some others like certain types of machine tools represented equipment for which we have surplus capacity.

Each category must be analyzed to see whether it is actually scarce.

The CHAIRMAN. I think the objection goes, perhaps, to tile claim that there has been a want of that type of analysis in the past.

Secretary HARRIMAN. Yes; and I am frank to say I am very glad the Congress has given us the money to control those shipments. I am very much in support of the view that they should be controlled within our desirable trade with Russia and tile East.

The CHAIRMAN. Let us give a little more attention to what happens when you plow back the consumer's money into his own pocket for his own spending.

He does not rush immediately to the grocery store and spend all of it for meat, does he? He has to pay rent. He has to buy clothes. He has to buy, maybe, a washing machine or a refrigerator, and he has to buy everything clear across our economy that we need for living. Is that not correct?

Secretary HARRIMAN. Yes. The standard of living is, by and large, higher than it has ever been. But we have seen that with full employment here are demands on products which are beyond what had been foreseen, and I must confess it is very encouraging to see what can be done to increase the standard of living of our people when we have full employment.

It will take some time before we get production in certain categories of products up to the point where we can satisfy the demands of our consumers with full employment.

The CHAIRMAN. Going to the next step, then, the consumer spends his dollars for many items not in scarce supply at all, and he might spend some of them for some items in scarce supply. Is that correct?

Secretary HARRIMAN. That is correct.

The CHAIRMAN. And does not the Government do the same thing when it retains his dollar?

Secretary HARRIMAN. When it spends the money, not necessarily when they retain the dollar.

The CHAIRMAN. When it spends the money.

Secretary HARRIMAN. If it uses surplus Government income to reduce the debt, it is deflationary.

The CHAIRMAN. And when you get into that, I suggest, Mr. Secretary, you get into a very delicate field where you can pull your props very easily out of your own economy. In fact, I think it is the general consensus of governmental opinion that, perhaps, the ambitious which prevailed a year ago, let us say, for a very massive, quick debt reduction no longer prevail, and it is now realized you can produce a harmful contraction of credit if you redeem those bonds from places where they form a credit base.

Secretary HARRIMAN. So far, Mr. Chairman, it is my judgment we are still in the inflationary period. What has happened so far to commodity prices in primary markets is helping correct time existing unbalance, rather than indicating a dangerous situation.

In my judgment, tax reduction should be retained for a period when we are in a deflationary period rather than at the present time.

That is my personal judgment.

The CHAIRMAN. Let me ask you this question, Mr. Secretary: I take it, then, it is a part of your philosophy that the Government, as a matter of policy, is warranted in taxing the citizen on the theory that during certain periods of time it can spend his money better than he can spend it himself?

Secretary HARRIMAN. No, sir; that is not my theory.

The CHAIRMAN. I think it follows from what you have said, Mr. Secretary.

Secretary HARRIMAN. No, sir.

My view is that during periods of inflationary pressures the Government should extract from the economy as much as possible in order to reduce the debt.

We must reduce the debt, and we must pay off our debt over a period of years, and the time to do it is during inflationary periods, in one of which we are now.

I certainly believe that during an inflationary period the Government should limit its expenditures to the minimum that it can and still effectuate our basic policies.

The CHAIRMAN. I am sure, as a generality, you would agree that you cannot set any definite sum of debt retirement for any future period as a wise amount of debt retirement.

Secretary **HARRIMAN.** No; I would not attempt to.

The CHAIRMAN. In other words, you could not today say that next year we should use all of our surplus for debt retirement, not knowing how much it would be, and not knowing what the conditions would be next year?

Secretary **No; I would certainly not do that. I do** believe there are certain types of Government expenditures, similar to those being made in other parts of our economy, where we are behind in necessary capital expenditures. Insofar as practicable, it would be well in deflationary periods to catch up on those necessary capital requirements though Government expenditures, rather than using money for debt retirement.

Under certain conditions, certainly I would be willing to advocate deficit spending if necessary for capital outlays. But in a period such as the present one of inflationary pressures, we do accumulate enough to make substantial debt retirements, and if we do not, we will never be in a position to deal properly with our debt problems.

The CHAIRMAN. You are not suggesting any definite amount for that purpose?

Secretary **HARRIMAN.** No, sir.

The CHAIRMAN. You go along with the general principle that we ought to reduce the debt when we can in relation to all the rest of our problems. Is that correct?

Secretary **HARRIMAN.** That is correct. I am only attempting to deal with the general situation as I see it, which makes me believe this is not the year for tax reduction.

The CHAIRMAN. Proceed, please.

Secretary **HARRIMAN.** The rapid expansion of nonfarm plant and equipment investment since the end of the war has raised the total at annual rates to over \$20,000,000,000 in the final quarter of last year. If you will turn back to table 1 you will see that this is a rate more than double that of 1941 as well as the boom year of 1929.

The CHAIRMAN. That might follow quite naturally, might it not, from the total rise in the gross national products?

Secretary **HARRIMAN.** Yes. I am showing in total dollar expenditures the very large average. Also I am showing thereon that it is a high percentage of our gross national product.

The CHAIRMAN. It is obvious, is it not, that as your national production increases it takes more investment to sustain it?

Secretary **HARRIMAN.** It takes more investment to expand it, of course.

The CHAIRMAN. Even to sustain it over a preceding lesser level. To put it in terms of obsolescence, you must have more replacement of obsolescence?

Secretary **HARRIMAN.** Increased volume naturally gives opportunities for improvement in production, and naturally there is a greater amount.

The CHAIRMAN. And also greater wear on existing plant?

Secretary **HARRIMAN.** That is true.

Table 4 on page 8 shows industrial, commercial, and public-utility construction and nonfarm producers' durable equipment as percentages of the gross national product for each year since 1919. We have used percentages for this purpose because they make it easier to see the underlying relationships without the fluctuations in dollar values caused by major price changes. The data are presented back to 1919 so as to present the picture of the period of high-level output of the 1920's as well as the later period when business volume was less satisfactory.

On the first column you will see total of construction and equipment, and it shows that the average 1919 to 1941 was 6.8 of our gross national product. 1947 was 8.7.

Then if you look at individual years, you will note that except for 1929, the 8.7 is higher than any individual year.

In 1929, it was 9.2. So that it is right up to the very peak and is substantially more than the average.

The industrial, commercial, and public utility new construction is somewhat under the average, but the equipment is higher.

I believe I am right in saying that industrial expansion is greater but commercial construction, new hotels and that sort of thing, has not been as great as it was during the boom years of the twenties. But business investment in equipment—7 percent of our gross national product—is substantially higher than in other years.

The CHAIRMAN. This is in dollars?

Secretary **HARRIMAN.** No; this is percentage.

The CHAIRMAN. The percentage rests on dollars?

Secretary **HARRIMAN.** Yes.

The CHAIRMAN. Is it pertinent to inquire as to the relation between the value of the dollar now and the value of the dollar in previous years?

Secretary **HARRIMAN.** Of course, the value of the dollar today is lower, but this is on the percentage of our gross national product which also reflects the shifting purchasing power of the dollar. It indicates the percent of our gross national product which goes into industrial and commercial expansion. The relative dollar is therefore not a factor in these percentages.

The CHAIRMAN. I would like to file a caveat on that for the time being.

Secretary **HARRIMAN.** All right, sir.

In other words, what I have been trying to say is that both in total expenditures and in percentages, this year has been a high year of investment in business expansion, and particularly high in industrial expansion.

The CHAIRMAN. My suggestions, if it has validity, Mr. Secretary, is that you necessarily have to make a higher dollar investment if the purchasing value of your dollar is less.

Secretary **HARRIMAN.** That is correct. That is why I put it both in dollar value and in percentages.

In 1947, industrial, commercial, and public-utility construction represented a little less than 2 percent of the gross national product, as shown in the second column of table 4. This rate is higher than in the 1930's but substantially lower than in the 1920's. Industrial construction is about the same percentage of the gross national prod-

uct as in the twenties. Commercial and public-utility construction are much smaller shares.

The situation in the outlays for producers' durable equipment is quite different, as may be seen quickly from a comparison of tile data in column 3 with the new construction figures in column 2. Producers' durable equipment includes industrial and office machinery, trucks, store fixtures, and so on. These equipment expenditures are now about 7 percent of the gross national product—the highest rate on record and considerably above the average level of the 1920's.

The CHAIRMAN. Was that not necessarily caused, Mr. Secretary, by the wearing out of machinery during the war and the whole train of prior obsolescence?

Secretary HARRIMAN. That has been certainly a factor. Naturally 1946 was also high. The expansion and the modernization of facilities, new production methods, and all that, have contributed as well.

The CHAIRMAN. Is it your understanding that business does not intend to spend as much for plant expansion in tile first quarter of 1948 as in the last quarter of 1947?

Secretary HARRIMAN. I think we have that in the next section. It is seasonably less in the first quarter, but I think, generally speaking, there is no change in the trend.

The CHAIRMAN. Does that come next?

Secretary HARRIMAN. Yes. If it is not satisfactory, may I try to add to the information?

In total, the nonfarm plant and equipment now constitutes a little less than 9 percent of the gross national product, above the average for the twenties and well above the average for the whole period 1919 to 1941. The average of less than 7 percent for the interwar period was sufficient to provide for replacements and in addition to provide a substantial growth in productive capacity. The high rate of growth from 1922 through 1929, particularly in construction, was a significant factor to be kept in mind in relation to what happened in 1929, though it is not my purpose today to go into the many factors that were at work to undermine economic stability at that time.

The CHAIRMAN. Mr. Secretary, is it not clear that if we are going to maintain a national income comparable to that which we have, and go further, we must have infinitely more plant and equipment than we had in prewar years, or back perhaps in the 1920's?

Secretary HARRIMAN. We certainly must.

The CHAIRMAN. Yes.

Secretary HARRIMAN. But it is a question of how much we can do in any one year, and what effect it would have if everybody constructed everything they wanted to construct in 1 year, or attempted to in a year or two. Then if you filled all of their needs, you would have a completely flat durable-goods industry.

The CHAIRMAN. If everybody started to do everything he wanted to do all at once, you would have a great raid on scarce markets, of course, but you would also be speeding up the day when you would have enough production to solve the question of scarce markets.

Is that not correct?

Secretary HARRIMAN. That is correct to a degree, although some expenditures do not necessarily directly effect increased production.

The **CHAIRMAN**. Roughly speaking, are there any capital expenditures that are not purely monumental that do not have any effect on production?

Secretary **HARRIMAN**. There are considerable business expenditures that have to be made which are necessary over a period of years that are not necessary for the immediate period.

You get into office buildings. You get into replacements of certain types of buildings.

Take in the case of the railroads the replacement of bridges. A bridge has to be renewed within a certain period, perhaps over a 5-year period. If you renew all your bridges at one time, and renew all your rails, and replace your equipment, if all that is done in 1 year, then they would not buy any equipment for several years to come.

The **CHAIRMAN**. The railroads have never done that, have they?

Secretary **HARRIMAN**. The railroads usually, unfortunately, have bought a lot of equipment when business is good and stopped buying it when business is bad, which has not been entirely sound from the standpoint of our general economy.

It would be better if they developed a method by which they could buy a relatively even amount of equipment year by year.

The **CHAIRMAN**. I suggest, and I am carrying coals to Newcastle, it somewhat depends on the financial status of the railroad.

Secretary **HARRIMAN**. It certainly does, and it also depends on the wisdom and farsightedness of the management.

I turn back now to my statement—to page 10. The present rate of investment is not only sufficient for replacement and normal growth but it also covers some making up of the deficiency accumulated during the war. A more rapid rate of investment would, of course, make up this deficiency more quickly, but this could not be accomplished without adversely affecting the current situation.

First, it would increase present inflationary pressures by diverting more of current output away from consumption.

Second, it would increase the pressure on our presently short steel supply since most investment requires substantial amounts of steel.

Third, it would tend to intensify the boom and make more difficult the readjustment to a normal growth rate when present deficiencies are made up.

Fourth, it would shift the distribution of output and production facilities in a way that could not be maintained for a long period ahead and hence would necessitate a painful readjustment at a later time. I want to emphasize that this readjustment would be just as painful for business as it would be for the general public. If I may illustrate this point by analogy, I would say it would be uneconomic as well as impossible for the automobile industry to expand to a point which would enable it to meet all the accumulated demand for cars in a short time.

The **CHAIRMAN**. Does the automobile industry contemplate any expansion of that kind?

Secretary **HARRIMAN**. At the present time, I am told that it is the short supply of steel which is affecting the production of automobiles. If you took more steel away from the automobile people and diverted it to construction, then there would be that much less production of automobiles.

The **CHAIRMAN**. Do I **get** the end point at which you have been driving **so far**, that taxes should not be reduced because if they were reduced **it** would increase the margins of savings which might be available for **investment**?

Secretary **HARRIMAN**. **No**. It would increase the inflationary pressures and would add to the great demand for goods.

The **CHAIRMAN**. Is it not your theory that you would increase the margins of savings out of which there might be capital to **do** the things which you think would be bad to **do**?

Secretary **HARRIMAN**. It is not clear that savings **would** result.

As I have said before, the indications are that the consumer would spend more money, which, with the present **volume** of goods, would **simply** mean the same amount of goods would be bid for at higher prices.

I resume with the text at the top of page 11. It might be added that a shift in the form of **investment**—that is, from producers' durable equipment and inventories to **construction**—**probably** would be desirable, for the reason that we have been making good our deficiencies in the former more rapidly than in the latter. But for the present all forms of investment **are** in sharp competition for the available supply of materials, labor, and other resources.

I shall review for you the evidence that we have on the current plans of business for capital expenditures, and on the size of the orders for capital equipment which manufacturers have on the books.

Our available data, computed from reports by business concerns, reveal that business expects to spend 4.1 billion dollars on plant and equipment in the first quarter of 1948. While this is about \$300,000,000 less than the estimate for the fourth quarter, it is well above the **average** for the four quarters of 1947. **The** drop from the fourth quarter of last year **is** of a seasonal nature, reflecting the slackening in the **winter** months. **The** first quarter estimate is more than one-fourth above the total in the opening quarter of 1947.

We have under way at the present time a survey of the intentions of business concerning their capital expenditures for the full year 1948. The returns are not in yet, but when they are received we shall **be** glad to **make** them available to this committee.

Senator **BYRD**. What were the total expenditures for capital investment in **1947**?

Secretary **HARRIMAN**. About \$20,000,000. That is in table 1-19.9 billion.

Senator **BYRD**. **What** do you estimate the total for 1948 to **be**?

Secretary **HARRIMAN**. I have said that we are reviewing that, and **we** do not have the data at this time. I simply indicated that the first quarter is **25** percent ahead of the first quarter of last year, although it is somewhat lower than the last quarter of last year, the latter decline being seasonal.

As **I** say, we have under way a survey of the intentions of business for **the full** year of 1948, and when the returns are in, **I** shall be glad to make them available to the committee if desired.

Senator **BYRD**. Do you think it will be more or less than **1947**?

Secretary **HARRIMAN**. I cannot answer that question until we get the figures.

I can only say that the estimates for the first quarter, which **we have**, are higher than **the first quarter of last year**.

If the committee is interested, I shall submit that.

How soon do you expect them?

Mr. **MEHIAN**. Before the end of this month.

Secretary **HARRIMAN**. We will send them in if you wish.

Senator **BYRD**. I am interested in how much money in the private enterprise system, so-called venture capital, will be invested this year as compared to last.

Secretary **HARRIMAN**. I am going on to discuss the way business has financed these expenditures.

The **CHAIRMAN**. Mr. Secretary, would you let me read into the record from the November 1947 monthly letter of the National City Bank:

In the present juncture, the supply of new savings out of the current incomes of individuals is seriously deficient in relationship to the demands for capital. For example, the individual investor has come close to disappearing as the source of new capital for private business. Estimates of the Securities and Exchange Commission indicate that individuals in all of 1946 added nothing net to their holdings of corporate stocks and bonds. The same is true for the first half of 1947. A major cause is income tax levels so high as to force continuous dissaving in the higher income brackets and shut down now supplies of saving farther down the line.

The individual savings that take place today in largest volumes are either institutionalized savings, reflected in accumulations of insurance and pension funds, or savings in anticipation of consumption. These funds are not available for equity investments in common stocks. The absence of substantial individual savings for taking risks of ownership is a serious missing link in the structure of sound financing of postwar prosperity. Without them, the pressure is on the corporation to sell bonds and to go further into debt to the banks and to the institutional investor. This has been the cheapest and easiest way of raising new funds. Often it has been the only practicable way.

Secretary **HARRIMAN**. I am dealing with part of that question later on. I would like to comment on it then, if I may.

Table 7 will show the purchases of various groups, including individuals.

The **CHAIRMAN**. All right. You may comment on it then.

Secretary **HARRIMAN**. After some hesitation in the second quarter of 1947, orders for machinery and other producers' equipment continued to rise in the last half of the year. The rate of increase in the production of those goods has been greater than the increase in new orders. Thus the year-end backlog of machinery producers, while slightly higher in dollar terms than at the end of 1946, was less in terms of months shipments. Even relative to the current high level of production, however, this backlog is much larger than before the war.

In the industrial construction field, contracts let during the final quarter of last year showed a substantial increase in comparison with the same period of 1946. It is too early to have any data as to the effect of the February price declines on either construction contracts or equipment orders.

So much for the current and prospective rate of investment. Let me turn now to the availability of funds. We have two sets of data which bear on this point. The first shows the various sources of savings which make the investment of the economy as a whole possible; that is, how much of the saving is made by persons, by corporations and by governments. The second shows the various direct sources of funds used for investment by corporations; that is, the amounts arising from internal sources and the amounts obtained from bank loans, common stock, and so forth.

The major sources of tile gross saving were individuals, undistributed corporate profits, depreciation and other capital consumption allowances, and the surplus of the Federal Government, with each of these accounting for roughly a fourth of the total. The figures are given in table 5. The Government saving to which I refer is not, of course, the budget surplus, but the excess of Government revenues over the Government's expenditures, for goods and services.

Saving by the Federal Government and its corporations and trust accounts consists chiefly of loans to foreign countries and of paying off the national debt, thus providing funds available for investment in the same way that current saving by persons and corporations is available for investment.

The CHAIRMAN. Mr. Secretary, if I understood that correctly, I would like to have a little further enlightenment on it. Exactly how would tile Government furnish risk capital for any one of the tells of thousands of little businesses around this country?

Secretary HARRIMAN. I will first deal with total savings and then with how much of it came from risk capital and how much from loans.

I am now only dealing with the sources of savings. In other words, personal savings are 10.9 billion.

Undistributed corporate profits are 10.6 billion.

Capital consumption allowance is 12.4 billion. That includes depreciation and depletion.

The over-all figures on Government include 3.9 billion dollars of loans abroad. That figure is 12.0 billion dollars and State and local 0.2.

The CHAIRMAN. I am referring to your statement:

thus providing funds available for investment in the same way that current saving by persons and corporations is available for investment.

Do you have any limitations on that?

Secretary HARRIMAN. Any what?

The CHAIRMAN. Limitations.

Secretary HARRIMAN. They are available for investments. As to whether they are invested in another matter, and I am going on to explain what was invested.

I have differentiated between investment and what tile City Bank was discussing, investment in equity financing. I am speaking of the total funds available for investment.

The CHAIRMAN. I am dropping a stitch here, and I would like to be set straight.

Your statement is:

Saving by the Federal Government and its corporations and trust accounts consists chiefly of loans to foreign countries and of paying off the national debt, thus providing funds available for investment in the same way that current saving by persons and corporations is available for investment.

I would appreciate a demonstration of that.

Secretary HARRIMAN. I am excluding, of course, the loans to foreign countries, but when paying off the national debt it gives to the holders of those securities moneys to reinvest in other securities.

The CHAIRMAN. But, as a matter of fact, if you take it out of the Federal Reserve System, you are contracting your credit supply, are you not?

Secretary **HARRIMAN**. If you pay off the insurance-company holder of investments in governments, they have that money to invest in other securities.

The **CHAIRMAN**. Take the insurance company. Do they engage in risk investment?

Secretary **HARRIMAN**. I am speaking about the total amount available not the total available for risk capital.

The **CHAIRMAN**. You are excluding risk capital from this paragraph?

Secretary **HARRIMAN**. This is the total investment, whether it be in bonds or bank loans or anything else.

The normal willingness of the private economy to save is necessarily low in relation to the abnormal volume of present investment needs that has arisen in large part from wartime shortages. This is especially true because the large accumulation of wartime savings has made it less necessary for consumers and businessmen to add to these liquid assets out of current income.

In this situation the Government has furnished a relatively large share of the saving that is currently available for investment; or to put it in another way, the Government has a substantial surplus. If the Government were not running this current surplus, inflationary pressures would have been greater than they have been. Investment demand and consumption demand have been competing for our limited resources since the end of the war. This has been a factor in forcing prices and incomes to even higher levels so as to provide the dollar saving equivalent to dollar investment.

I turn now to the second set of data which relates to the sources and uses of funds. During 1947 and at present there has been relatively little difficulty in financing what I have previously stated to be the largest expenditure on business facilities of record. Funds available from current operations—that is, through retained profits and depreciation charges—have been about twice as large as those obtained through securities or bank loans.

The **CHAIRMAN**. Mr. Secretary, you state:

Funds available from current operations—that is, through retained profits and depreciation charges—have been about twice as large as those obtained through securities or bank loans.

Secretary **HARRIMAN**. Yes.

The **CHAIRMAN**. That is in part due to retained profit from the war period?

Secretary **HARRIMAN**. That is retained profits during the year 1947, currently retained profits, not previous profits.

The **CHAIRMAN**. That is not a dependable source for future expansion, is it, unless you wish to deprive the stockholder of dividends?

Secretary **HARRIMAN**. No. I am only dealing with the current year. I am very ready to say that in the future it will be necessary, in my judgment, to make it far more attractive for risk capital than it is at the present time.

I am only speaking of the present time. I will say now, as long as the subject is up, I agree that in the future it will be necessary to give greater incentive for risk capital, and it will be very dangerous to our economy if we do not give it.

I am only saying that I do not believe this is the year to give that incentive.

Senator **BYRD**. Mr. Secretary, how would you give that incentive?

Secretary **HARRIMAN**. Through reduced taxes at the appropriate time.

Senator **BYRD**. Anything else except reduced taxes by which you could encourage risk capital?

Secretary **HARRIMAN**. We are dealing with taxes.

Senator **BYRD**. Do you think that risk capital is going freely into these new industries and plant expansion, and so forth, now?

Secretary **HARRIMAN**. What, sir?

Senator **BYRD**. Do you think risk capital is going as freely as it should into these plant expansions and so forth?

Secretary **HARRIMAN**. May I finish this, and then perhaps you can cross-examine me if you like?

Senator **BYRD**. I wondered why you say it ought to be delayed a year if necessary now.

Secretary **HARRIMAN**. What I am attempting to show is that there is ample funds for this very large expansion which is taking place.

Senator **BYRD**. Where do those funds come from?

Secretary **HARRIMAN**. I think I will show you, if you bear with me for a moment.

Senator **BYRD**. All right.

Secretary **HARRIMAN**. Interest rates are still low, both for corporate bonds and for bank loans, and in view of the high rate of return on invested capital, tend to stimulate business borrowing. As a result, it is not surprising that a high proportion of new security issues have taken the form of bonded indebtedness.

The **CHAIRMAN**. Mr. Secretary, does that not indicate that equities are not considered a good buy?

Secretary **HARRIMAN**. At the present time there are ample funds available at relatively very low rates of interest for borrowing.

I will show you the relative investments, if I may, as we go along, and then will be glad to discuss the need for equity financing which is, as I say, necessary in the future and will be needed.

There is little indication of any deficiency of funds available for investment from the point of view of financing the current rate of capital expansion. Secretary, does that not rest on the assumption

that corporations will continue to have the same kind of reserves they have now for internal financing, and, secondly, that it will continue to be advisable to run our business on an indebtedness rather than an equity basis?

Secretary **HARRIMAN**. I am very much opposed to business going too much into debt over the years.

If you will bear with me, I will attempt to show that is not a dangerous situation now, and that it has been natural for corporations to borrow at these low rates of interest rather than to issue equity securities.

If there were a greater amount of money available for equity securities we would have a dangerous boom like we experienced in the twenties, and it might lead to an unfortunate need for readjustments in the future.

I want to make it perfectly plain that I earnestly believe there must be readjustments of taxes at the appropriate time in order to make it of interest for investors to take risks.

Senator **BYRD**. When do you think, Mr. Secretary, that appropriate time will come?

Secretary **HARRIMAN**. I would not attempt to foresee it, but I am trying to develop the basis for my judgment that it is not this year.

Turning back to my statement, a similar conclusion is reached when the current rate of saving and the level of funds available for investment are compared with prewar years of peak business activity such as 1929.

The substantial demand for corporate bonds by life-insurance companies is particularly notable. During the past 2 years these companies bought on balance a volume of corporate bonds in excess of the increase in corporate bonds outstanding. Their enormous holdings of United States Government securities plus the steady flow of funds into new insurance at the current rate of over \$3,000,000,000 a year would seem to insure a continuance of a strong demand for corporate bonds from this source.

As long as businesses can obtain borrowed funds at the present low rates, it seems likely that a high proportion of capital requirements will continue to be satisfied through fixed-interest-bearing obligations. Though business, I am sure, recognizes the dangers of too great dependence upon borrowed capital, the present corporate financial structure does not represent one in which fixed interest charges are a dangerous burden for corporations as a whole. The ratio of interest payments by corporations to profits before interest and taxes amounts to 8 percent at present, compared with 12 percent in 1941 and 23 percent in 1929.

To indicate the manner in which business finances its needs for funds in 1947, it would be necessary to have a complete source and use of funds analysis for the entire business economy. We do not have such data available; however, it is possible to supply some tentative data for the corporate sector of the economy. The figures are given in table 6.

In 1947, corporations expended 14.5 billion dollars on plant and equipment, \$7,000,000,000 on enlarging their inventories, and added roughly \$5,000,000,000 to their trade receivables. This aggregate of 26.5 billion dollars was financed by approximately 14.5 billion dollars of retained profits and depreciation reserves, \$1,000,000,000 of net new capital issues, and 3.5 billion dollars of bank loans and mortgages, as well as by a billion-dollar increase in trade payables, a \$3,000,000,000 increase in income-tax liabilities and other payables, and a half billion dollar reduction in liquid assets.

That is what I have stated is covered by table 6 on page 17.

The **CHAIRMAN**. Mr. Secretary, I think this might have been an appropriate time to get at what might be the scope of an income-tax reduction bill and what relation that might be on enhancing the possibility of finding risk capital.

Secretary **HARRIMAN**. I think I have one more table to cover. I am sorry to be so tedious, but, if I may, I would like to show how the savings have been made through table 6, and then I shall be glad to discuss that point.

The **CHAIRMAN**. All right.

Secretary **HARRIMAN**. It appears, therefore, that to finance 26.5 billion dollars in capital requirements, corporations needed to raise not much over 7.5 billion dollars through new issues and bank loans,

nor were they compelled to reduce their liquid assets to a significant extent as had been the case **in the** previous year. **In** 1946, in contrast, it is estimated that the reduction **in** their cash and **Government** securities, mainly **the latter**, amounted to 6.5 billion dollars. The increase in bank loans in 1947 was almost identical with that **in** 1946, but the increase in **net** security issues was substantially larger.

As is shown in table 7, approximately half of the increase **in** security issues during 1947 is attributable to **the** industrial and miscellaneous industries, primarily manufacturing. The other half is almost evenly divided between the telephone and electric and gas utilities. **The** new industrial issues dropped somewhat from 1946, whereas **the** volume of public-utility issues, other than railroads, increased very substantially. Two-thirds of the net issues in 1947 were bonds and notes, with the remainder distributed between common and preferred stock.

I might say in passing that one of the very large issues was that of the telephone company. It represented debentures, and I am told that was a convertible issue. Some of those bonds have been converted to stock, which would somewhat change that percentage. That is, you figure the conversion into stock as having **the** net effect of increasing the equity issues.

The banking system took only a very small proportion of the increase in securities outstanding during the year, but life-insurance companies bought on balance **an** amount equivalent to the entire increase in bonds and notes. **The** performance of these institutions in 1947 was quite similar to that of 1946. However, individuals in 1947 added \$700,000,000 to their securities portfolio, mostly in the form of stocks, whereas in 1946 they had bought stocks on balance and sold substantial amounts of bonds with no change in net position.

That, you will see, is at variance with what the National City Bank, if I remember correctly, said.

You see that commercial banks added \$200,000,000 to their security portfolio; mutual savings banks, \$200,000,000; life-insurance companies \$3,000,000,000; domestic individuals increased their holdings by \$700,000,000.

I understand that most of that was in the form of stocks.

You will notice in 1946 **the** pattern was what I understood the City Bank statement said, that the stocks bought and sold on balance made no change in **the net position**.

The **CHAIRMAN**. Would this be an appropriate time to take a look at your table 7?

Secretary **HARRIMAN**. Yes.

It shows that the net security issues **by** industrial groups: \$2,000,000,000 industrial; \$2,100,000,000 public utility, including tile telephone, which is a very large issue.

Rilroad, zero.

Total common stock, \$900,000,000.

Total preferred stock, \$400,000,000.

Bonds and notes \$2,800,000,000, and the purchases were **given by** groups below.

The CHAIRMAN. How did the railroads finance themselves in 1946 and 1947?

Secretary **HARRIMA** . I gather on balance there was repayment for railroad securities equal to the **new** securities issued.

The CHAIRMAN. Do not ~~the~~ railroads afford a textbook example of the danger of increasing the indebtedness of corporations out of proper relation to the equity capital?

Secretary **HARRIMAN.** During the thirties, ~~the~~ overbalance or the large percentage of bond indebtedness as against equity capital was, of course, one of the reasons which contributed to the difficult financial position of the railroads.

The CHAIRMAN. Is it not correct to say, Mr. Secretary, that with very few exceptions there is not an important railroad in the United States that has not been in and out of receivership, principally due to the cause that it could not meet fixed charges involved in its fixed indebtedness?

Secretary **HARRIMAN.** If you go back to all time, I imagine that is true. I have been out of the railroad business for nearly 8 years, and I do not recall the history as well as I used to. But, generally speaking, most railroads have been in and out of receivership.

The CHAIRMAN. The thing that puts a railroad or anybody else into receivership is because it cannot meet fixed indebtedness, is it not?

Secretary **HARRIMAN.** Yes. Few railroads were not able to pay their operating expenses. It was the capital charges.

The CHAIRMAN. What is amicable to any business in tough times.

Secretary **HARRIMAN.** That is correct.

The CHAIRMAN. If they cannot meet their fixed charges, the banks take over.

Secretary **HARRIMAN.** That is correct.

The CHAIRMAN. Coming down to your net issues by type of security, I invite your attention to the fact that there was an increased issue of \$1,000,000,000 in 1946, and a decrease to \$900,000,000 in 1947.

All of these figures are net.

Secretary **HARRIMAN.** That is correct.

The CHAIRMAN. Preferred stock \$300,000,000 in 1946, \$400,000,000 in 1947.

Bonds and notes, \$1,000,000,000 in 1946, and \$2,800,000,000 in 1947.

Is that last item not a significant indicator of the substitution of indebtedness for equity capital?

Secretary **HARRIMAN.** May I turn to table 8. It shows the historic percentages.

The comparison of prewar and postwar stock issues, total new issues, between 1919 and 1928, all corporations, the percentage of equity financing was 32 percent.

In 1929, you remember we had very high interest rates and a very high stock market. Stocks were selling on a fantastic basis.

Senator **LUKAS.** We had a high mortality rate, too.

Secretary **HARRIMAN.** After the end of 1929, but during 1929, the stocks were selling at a very low rate of return and on a highly speculative basis.

There were a lot of conversions.

Between 1930 and 1941, 25 percent; 1946 was 42 percent; and this year was 26 percent.

Mr. Meehan, do you know what proportion of those telephone convertible debentures were converted in the last few months?

Mr. **MEEHAN.** One-sixth of the December 1940 issue has been converted. Of the December 1947 issue, we only have the figures for

the first 2 days, in which the conversion privilege could be exercised. During the first 2 days, 10 percent was converted.

Secretary HARRIMAN. So that would have changed it. The first three quarters was about the same as the average of 1919-28.

The CHAIRMAN. The risk of a public utility security, generally speaking, is less than that of an ordinary industrial security, is it not?

Secretary HARRIMAN. Yes, sir.

The CHAIRMAN. That would have pertinent bearing, I suggest.

Secretary HARRIMAN. That does.

That debenture issue was included as a debt. This will change the situation for the year, if the conversion is included.

This is certainly a year in which there is a high percentage of corporate financing on indebtedness, and a low percentage in equity financing.

There is no question about that.

The CHAIRMAN. Let us look at these net purchases by various groups.

You have an item for commercial banks. Commercial banks do not buy high-risk securities, do they?

Secretary HARRIMAN. No. They undoubtedly would be high-grade securities.

The CHAIRMAN. You have mutual savings banks. Mutual savings banks do not buy high-risk securities, do they?

Secretary HARRIMAN. That is correct.

The CHAIRMAN. And you have life insurance companies, which is the largest item of all, \$2,000,000,000 in 1946 and \$3,000,000,000 in 1947.

Life insurance companies do not engage in high-risk securities, do they?

Secretary HARRIMAN. That is correct.

The CHAIRMAN. I have no idea what the foreigners are investing in, but in any event, they did not invest anything in 1947.

Secretary HARRIMAN. That is right. They reduced their investment by \$200,000,000 in 1946 and added nothing in 1947.

The CHAIRMAN. And domestic individuals acquired nothing in terms of net purchases in 1946 and \$700,000,000 in 1947.

Secretary HARRIMAN. That is correct.

The CHAIRMAN. Turning to table 8, to which you referred, 1930-41 was a very depressed period.

I wonder if there is any prophecy between that figure of 25 percent and the figure in 1947 of 26 percent.

Secretary HARRIMAN. There was very little risk expansion in that period.

The CHAIRMAN. I doubt whether you could make a full scale argument from the figures but it is significant.

Secretary HARRIMAN. Have we got the figures of total indebtedness with us?

Mr. MEEHAN. Yes.

Secretary HARRIMAN. The corporations, of course, paid off a considerable amount of their debt during the war, if I remember correctly.

May I read these figures? I think they are important.

I want to make it perfectly plain I do not believe in a high percentage of debt for corporations, but I do not believe that to date it is dangerous.

The CHAIRMAN. Would you agree, Mr. Secretary, it is dangerous tendency? Obviously, if it is a dangerous tendency, it has to be stopped or it will become dangerous.

Secretary **HARRIMAN.** It is a natural tendency for corporations to borrow when they can borrow very cheaply, and certainly if it continues, if there is an unbalance between debt and income, it becomes a dangerous situation.

I pointed out earlier that at the present time only 8 percent of the income of corporations is taken by interest payments, today, whereas in 1929 it was 23 percent.

The totals on debt: Taking 1930, which was the peak, \$61,000,000,000 of long term debt of all corporations whereas in 1947 it is \$53,000,000,000.

In total indebtedness of all kinds, it is about 112 as against 107.

The corporations reduced their debt from \$110,000,000,000 in 1943 to \$99,000,000,000 in 1945.

The CHAIRMAN. Let us have the income levels for the years you are comparing.

Secretary **HARRIMAN.** I have not got the income levels.

Mr. MEEHAN. Here they are.

The CHAIRMAN. Would it bother you unduly if they were supplied, and in connection with reading that, you read us the income levels?

Mr. MEEHAN. Do you want the national income, Mr. Chairman?

The CHAIRMAN. That will be all right.

Secretary **HARRIMAN.** In 1929, when our national income was \$87,000,000,000, the total debt was \$107,000,000,000, whereas in 1946 our national income was \$178,000,000,000 and our corporate debt was \$102,800,000,000.

The CHAIRMAN. What relevancy does that leave to your figures?

Secretary **HARRIMAN.** I thought you asked for the national income.

At a time when we are on a very much higher basis of business activity, our debt situation is not substantially different than it was in the period of very much lower business activity.

The price levels, also, of course, were quite different.

The CHAIRMAN. I believe this would be a good time to ask you to bring your theories in relation to what may happen around here in the way of a tax reduction bill.

Think we agreed earlier in the day, at least it would be implied from what we discussed, as far as the reduction going to the lower income brackets is concerned, we cannot count on that as a source for risk capital.

Is that correct?

Secretary **HARRIMAN.** I did not quite get that.

The CHAIRMAN. As to the effect of any reduction tax bill passed here, the reduction that goes to the lower brackets would not constitute a source for risk investment capital, would it?

Secretary **HARRIMAN.** No.

The CHAIRMAN. So it follows, then, we have to look to the middle and tipper income brackets for that.

Secretary **HARRIMAN.** And to corporate savings.

The CHAIRMAN. It has been predicted, and I am not taking the liberty of setting any figure, when finished we will have a tax-reduction bill somewhere, say, in the order of \$4,500,000,000, something like that.

Assuming that the percentage of distribution is the same as under the Knutson bill, that would put \$1,114,000,000 into the middle and upper income brackets.

Now, it is perfectly obvious, is it not, that that whole sum would not be immediately rushed into risk capital? You agree with me on that?

Secretary HARRIMAN. I would think so; yes.

The CHAIRMAN. In other words, many people are now living on capital. This might help them come up to an even standpoint.

Many people have many things they could use that money for without putting it in risk capital. Is that not correct?

Secretary HARRIMAN. That is correct.

The CHAIRMAN. When you finish these calculations of that nature, you can see that at most what we do here, if what we do is in the order that I have mentioned, is only a step and a short step toward restoring the money pool for risk investment by tax reduction.

Do you think, putting any figure on it you want to, that the remaining amount of money which would be left to those in the middle and upper brackets as the result of tax reduction in the order I have mentioned would conflict seriously with your own theories?

Secretary HARRIMAN. I think that any tax reduction will add to inflationary pressures, sir, and if I am right in feeling we are still in a period of danger from inflation, it will add to inflationary pressures.

The people who get the money will either spend or save it.

As you have indicated, they are apt to spend it under present conditions, and there will be a greater demand for goods and services which are not adequate today to meet the present demand.

The CHAIRMAN. Mr. Secretary, we have already discussed the consumer angle of the business. I am now talking solely about a tax reduction as a source for investment capital, risk capital.

Call you conceive of what we are doing here, if what we do approaches a figure such as I have mentioned, as interfering seriously with your own theories as to the present inadvisability of increasing risk investment?

Secretary HARRIMAN. I do not think I can divorce its effect upon the economy as a whole, which has been dealt with in this paper. I think you will add to inflationary pressures, and the people will attempt to spend more and will tend to increase the excess demand over supply.

I think it will have further repercussions which will make it more difficult when the adjustment period comes.

From the standpoint of increase of equity capital, probably some of it will go into equity capital funds, certainly on a net basis.

As you say, many people in the higher-income brackets have had to live on capital, and presumably they have sold securities if they did not have savings in cash. So that it will reduce the sales of securities held by individuals, and I would think it would add to investment in equity to some extent.

How much, I would not want to estimate.

The CHAIRMAN. The burden of your argument, if I understand it, has been this is not the time to increase the pool of available risk capital by tax reduction.

I am asking you on that limited angle: Do you consider that what would be done by this tax-reduction bill would seriously upset even your own theory as to that?

Secretary HARRIMAN. May I say, Mr. Chairman, I have dealt with two phases. One is the excess demand for goods over available goods and services, and the other was dealing with this argument as to funds available for capital expenditures.

I have not entered in detail the various tax proposals, but I do believe it will add to our inflationary pressures, and I cannot divorce that from the equity-capital situation.

It will make some more money available for equity financing which I do not think is needed at the present time. So I do not think the effect of it will be useful to our economy at the present time.

The CHAIRMAN. Let us take the effect of it so far as risk investment is concerned.

It presents simply an alternative between so much more money available for equities or financing necessary through indebtedness.

A corporation gets money by incurring indebtedness and it buys the scarce materials you are referring to just as it does if it gets it by equity, does it not?

Secretary HARRIMAN. That is correct.

The CHAIRMAN. So the inflationary interest is there, whether financed through indebtedness or by equity, which leaves the problem, so far as risk capital is concerned, for us to estimate the good or bad effects from what would be left for risk investment out of \$1,114,000,000 of reduction in the middle and upper brackets.

Secretary HARRIMAN. Of course, I have no way to estimate how receivers of that tax reduction will spend it.

The CHAIRMAN. I wish we had more cause for concern over flat. I wish we would reduce it a lot deeper.

Secretary HARRIMAN. I have been very frank in saying I earnestly believe at the proper time there should be a full recognition of the fact that this country has been developed by risk capital, and if we are to attain a dynamic economy, which we have to have, over the years we must encourage risk capital.

I am only saying I do not believe this is the year to do it. And if we do it, we will go into more of a business boom than we have today. We already have a substantial one. It will add to the difficulties when the adjustment comes.

The CHAIRMAN. Mr. Secretary, you have drawn a good audience, and there are some complaints that you are not speaking loud enough.

Secretary HARRIMAN. I am sorry, sir.

Senator LUCAS. May I make one inquiry on this point?

The CHAIRMAN. Senator Lucas.

Senator LUCAS. Is there any speculative guess as to what amount of this \$1,000,000,000 you have been discussing will go into risk capital?

The CHAIRMAN. I beg your pardon, Senator Lucas.

Senator LUCAS. We have been discussing all through these hearings in questions and answers equity capital, and the chairman a moment ago estimated there would be 1.1 billion available for equity capital in the event they wanted to put it into that.

The CHAIRMAN. It would not all be available.

Senator LUCAS. I was wondering whether anybody made a speculative guess as to what portion of that amount would go into equity capital.

The CHAIRMAN. I am trying to get the Secretary's opinion. I think it is hard to figure out, but certainly in my judgment it will be less than \$1,000,000,000.

Senator **LUCAS.** It certainly will, in my opinion.

In my judgment, there will be very little of this money going into equity investment, but through all these hearings, the impression, as I got it, has gone out that this is a tax bill to have a lot of capital to flow into equity investment.

As I see it, this is just a plain cut of the tax bill for the taxpayers of this country, and those who are interested in equity capital are not going to get very much relief out of this tax bill.

The CHAIRMAN. Senator Lucas, I think everyone who has studied this matter, as you have, realizes the value of what we are doing here, if it has value, is as a first step, and the people that I have talked to who are acquainted with equity markets tell me it would have a tremendously valuable and constructive effect psychologically to know the Congress had taken that first step.

Senator **LUCAS.** I hope that is true if the tax bill is passed. I am only stating the facts as they have been presented to us.

It may be a shot in the arm for these fellows to get more equity capital in the market, but the only way they can really get any relief is to have a real tax cut and not one like we have at the present time.

Senator **BYRD.** I understand the Secretary conceded the fact the reduction of taxes would provide additional equity capital.

Secretary **HARRIMAN.** I am assuming so, and would not want to hazard a guess as to what effect it would have—as to how much would be saved in the middle and higher income brackets.

But certainly I agreed with the chairman that many people are living on their capital in some of those categories, and that it might have some net effect on investment in equity during the course of the year.

I would not want to hazard a guess as to how much. It might prevent certain people from selling who are now selling securities.

May I finish my statement?

The CHAIRMAN. Go ahead.

Secretary **HARRIMAN.** At the end of 1947 the liquid position of corporations as a whole was still favorable by prewar standards. The ratio of liquid assets to sales or to current liabilities was generally higher than it had been just prior to our entry into the war or in the twenties.

Since there is a particular interest at present in the relative importance of equity and other capital financing, it may be noted that the 1946 ratio of new stock issues to total new money issues was generally above the prewar ratios with the notable exception of 1929 (table 8). In 1947, the relative importance of stock issues dropped to a ratio somewhat below the 1919-28 period and slightly higher than in the 1930-41 period.

In connection with the market valuation of equity capital table 9 is of interest. This shows the current dividend yield on common stocks and the ratio of earnings to price. The present relationship between market price of common and dividends and earnings per share is almost identical with that in the mid-twenties, though considerably less than in the bull market which occurred from 1927 to 1929.

A more important difference between the cost of investment funds today and in the twenties lies in the trend of interest rates. Although interest rates have gone up, moderately in recent months, they are still low in historical perspective. Corporate bond yields currently average 3.1 percent as compared with 7.0 percent in the early twenties, 5.2 percent in 1929, and 3.8 in 1930. Commercial rates charged customers by banks in principal cities now average 2.2 percent as compared to 2.8 percent in 1930 and much higher rates in the twenties. Lower rates, of course, are paid by large, well-established firms, while new and small concerns typically pay higher rates. It is rather striking that the average rate paid on the very substantial amount of term loans extended by banks—that is, loans with maturity over a year—is slightly less than 2 percent. Such loans were virtually unknown prior to the mid-thirties.

If we turn to table 9, we will see what I said of the ratio. You take the bond yield of the first column and the dividend yield of the second column. You will see that the latter in January was 5.4 which does not differ much from the ratios up to the middle twenties. After that, of course, we went into the bull market.

On the basis of earnings, you will see the ratio of 11.3 today is the same as last year, and in the middle twenties you have comparable figures.

In the bull market, of course, they are on a very much different basis.

The CHAIRMAN. Mr. Secretary, cannot a strong argument be made that the current dividend yield on common stocks in their ratio to price indicates that people are not interested in equities?

Secretary **HARRIMAN.** If you compare the current period with the recovery period in the middle twenties, you will see that the present dividend yield in relation to the market value is not much different than it was for the average between 1926 and 1929.

You have to get to 1927, 1928, and 1929 before your dividend yield was lower in relation to price.

From the standpoint of earnings, you will see the recent ratio is the same or about the same as between 1923 and 1926. So that your price today in relationship to dividend and earnings is much the same as it was between 1923 and 1926.

So, it does not lend color to the idea that stocks are selling at a very low basis, compared to their dividend yield and earnings.

The CHAIRMAN. Do they sell at a low basis in relation to the low interest rates you are speaking of?

Secretary **HARRIMAN.** In relation to the low interest rate, yes.

The CHAIRMAN. So that people have a choice of going in for low interest rates or taking these equities?

Secretary **HARRIMAN.** Yes.

The CHAIRMAN. And they are taking the low interest rates?

Secretary **HARRIMAN.** There is a large amount of savings that is going into insurance policies and increasing assets of insurance companies which are going into bonded indebtedness.

I resume from my statement, page 21. While the adjustment of the premiums on Government long-term bonds and the advance in the short-term rates have resulted in some adjustment of yields, the general policies with respect to the management of the public debt have not been changed. I comment on this only briefly since the officials responsible for these matters have already presented their

analyses and views to the Congress. My point is that, insofar as the availability of funds for the needs of business is concerned, the changes in money markets have influenced the rate structure only in a slight degree. The changes do not alter the general picture of low costs for borrowed capital.

In summary, then, I would emphasize that our economy is still in an inflationary situation and that sound policy demands that the level of taxation is maintained. Both capital formation and consumption are at record levels. We are utilizing all our economic resources. The major effect of any lowering of taxes, therefore, would be to raise demand and thereby prices, rather than to bring forth increased supplies.

This does not mean that the present rate or structure of taxes that have a bearing upon the availability of risk capital should be retained beyond the present peril of inflationary pressure. These inflationary pressures undoubtedly will disappear. Tax adjustments will then be necessary and desirable. One important objective of such relief, it seems to me, would be to encourage business investment, particularly as financed by equity capital. However, as I have indicated earlier, business capital expenditures are already taking a relatively large share of our national output. In view of the other small share of total output, and the resulting inflationary pressure, I do not believe that now is the time for tax reductions that would lower Government revenues in order to stimulate additional investment.

(The tables referred to are as follows:)

TABLE 1.—Gross national product or expenditures, 1920-47

Year	Gross national product	Gross private domestic investment				
		Personal consumption expenditures	Plant and equipment	Nonresidential construction	Residential construction	Net foreign investment
1920.....	103.8	78.8	9.6	6.3	0.8	
1921.....	90.9	70.8	7.4	2.8	.7	
1922.....	78.9	61.2	4.6	1.9	.2	
1923.....	81.3	59.2	2.4	-1.1	.2	
1924.....	85.8	48.3	2.2	1.0	.1	
1925.....	64.9	51.9	3.0	1.2	.4	
1926.....	72.2	60.2	3.7	1.4	.7	
1927.....	2.5	62.5	8.1	3.3	-1.1	
1928.....	90.7	67.1	6.3	3.1	.1	
1929.....	84.7	64.5	4.4	1.9	1.1	
1930.....	90.4	67.5	5.2	3.8	.9	
1931.....	100.5	72.1	6.9	6.1	1.6	
1932.....	125.3	82.3	8.7	8.6	1.1	
1933.....	150.6	90.8	8.2	4.1	-2.2	
1934.....	192.6	101.6	5.2	.7	-2.2	
1935.....	210.6	110.4	5.4	.3	-2.1	
1936.....	213.1	121.7	7.6	1.8	-1.8	
1937.....	203.7	143.7	14.8	9.8	4.8	
1938.....	229.6	164.4	19.9	7.9	8.7	

Seasonally adjusted annual rates

1947—Fourth quarter.....	240.9	172.6	20.8	9	0.3
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* Includes new industrial, commercial, and public utility construction and producers' durable equipment expenditures excluding farm machinery and tractors.

† Includes new residential and institutional construction, farm construction, and equipment expenditures, and net change in business and farm inventories. The net decline in inventories 1932-34 was large enough to more than offset the positive items in this category.

NOTE.—Detail will not necessarily add to totals because of rounding.

Source: U. S. Department of Commerce, Office of Business Economics.

TABLE 2.—Percentage distribution of gross national product, by major expenditure

Year:	Personal consumption expenditures	Gross private domestic product			Net foreign investment	Government purchases of services
		Government expenditures	Investment	Consumption		
1929	75.9	9.2	6.0	.7	82	
1930	77.9	8.1	3.1	.8	10.1	
1931	80.5	5.90	4.1	.3	12.1	
1932	84.4	4.1	-2.0	.3	13.8	
1933	83.1	3.90	-1.65	.3	14.33	
1934	80.0	4.6	.3	.7	16.0	
1935	77.9	5.1	3.4	-1.1	13.7	
1936	77.8	6.1	4.0	-	14.2	
1937	74.4	7.0	5.7	.1	12.8	
1938	76.2	5.2	2.2	1.3	16.1	
1939	74.0	5.7	4.3	1.0	14.4	
1940	71.7	.8	6.11	1.5	13.9	
1941	65.7	7.0	6.77	.9	19.7	
1942	56.9	3.2	2.65	-1.1	37.4	
1943	52.8	2.0	.4	-1.2	46.0	
1944	52.4	2.5	.2	-1.0	45.9	
1945	57.1	3.6	.7	-4	39.0	
1946	70.5	7.3	4.8	2.3	16.1	
1947	71.6	8.7	3.4	3.8	12.5	

Seasonally adjusted annual rates

1947—Fourth quarter..... 71.6 .. 8.6 .. 83.8 .. 3 .. 12.0

† Includes new industrial, commercial and public utility construction and producers' durable equipment expenditures excluding farm machinery and tractors.

‡ Includes new residential and institutional construction, farm construction and equipment expenditures, and net change in business and farm inventories. The net decline in inventories 1932-34 was large enough to more than offset the positive items in this category.

NOTE.—Sum of details may vary from 100.00 percent by 0.1 due to rounding.

Source: U. S. Department of Commerce, Office of Business Economics.

TABLE 3.—Disposition of personal income

Year	Total personal income	Percentages of total personal income			
		Tax payments	Consumption expenditures	Savings	
	Billions of dollars	Percent	Percent	Percent	
1929	85.1	3.1	92.5	4.4	
1930	76.2	3.3	92.9	3.88	
1931	64.8	2.90	94.3	2.88	
1932	49.3	2.9	99.9	-2.8	
1933	46.6	3.1	99.4	-2.2	
1934	53.2	3.0	97.5	-1.5	
1935	59.9	3.2	93.9	2.9	
1936	68.4	3.3	91.5	5.2	
1937	74.0	2.0	90.7	5.2	
1938	68.3	4.2	94.4	1.4	
1939	72.6	3.4	92.9	3.7	
1940	78.3	.3	92.0	4.7	
1941	93.3	3.5	89.3	10.22	
1942	122.2	4.9	74.33	20.88	
1943	149.4	11.9	68.0	20.1	
1944	164.0	11.68	66.9	21.61	
1945	171.6	12.2	70.9	16.9	
1946	177.2	10.6	81.1	8.36	
1947	181.8	10.9	83.6	5.5	

† Chiefly individual income taxes but also including such items as estate and gift taxes and personal property taxes. Business taxes are not included. Including excise taxes.

Source: U. S. Department of Commerce, Office of Business Economics.

TABLE 4.—Nonfarm plant and equipment investment, total and components as percentage of gross national product

Year	Total	Industrial, commercial and blfe construction	Nonfarm producers' durable equipment expenditure ¹	Year	Total	Industrial, commercial and construction	Nonfarm producers' durable equipment expenditures
1911	7.4	1.9 ²	5.5	1931	6.1	1.2	4.9
1920	7.9	2.8	5.1	1932	7.0	1.6	5.4
1921	6.7	2.6	4.1	1933	6.2	1.4	4.8
1922	6.5	2.6	3.9	1934	6.7	1.3	4.6
1923	7.9	2.9	5.0	1935	6.8	1.3	5.5
1924	7.6	3.0	4.6	1936	7.0	1.5	5.5
1925	7.8	3.0	4.8	1937	3.2	.7	2.5
1926	8.4	3.4	5.0	1938	2.0	.3	1.7
1927	8.1	3.5	4.6	1939	2.5	.4	2.1
1928	8.2	3.3	4.9	1940	3.6	.7	2.9
1929	9.2	3.6	6.7	1941	7.3	1.8 ^B	5.5
1930	8.1	3.3	4.8	1942	8.7	1.7	7.0
1931	5.9	2.1	3.8	1943	Annual aver.		
1932	4.1	1.3	2.8	age, 1919-			
1933	3.9	1.0	2.9	41	6.8	2.2	4.6
1934	4.6	1.0	3.6				
1935	5.1	1.0	4.1				

Source: U. S. Department of Commerce, Office of business Economics. The years 1919-28 based on unpublished data.

TABLE 5.—Major items of gross saving, 1947

(Billions of dollars)

Gross private saving:	
Personal saving	10.9
Undistributed corporate profits	10.6
Capital consumption allowance	12.4
Government saving:	
Federal (including \$3,000,000,000 of loans abroad)	12.0
State and local	.2
Surplus on income and product transactions.	

Source: U. S. Department of Commerce, Office of Business Economics.

TABLE 6.—Sources and uses of corporate funds, 1947¹

(Billions of dollars)

Uses	20.7
Plant and equipment: ²	
New	14.2
Government	5
Inventories (book value)	6.7
Receivables (trade):	
From business	4.0
From consumers	1.3
From Government	2
Other current assets (excluding cash and U. S. Government securities)	.2

¹All United States corporations, exclusive of banks and insurance companies.

²Does not include outlays charged to current account.

TABLE 7.—Sources and uses of corporate funds, 1947—Continued

Sources	26.7
Retained profits	10.1
Depreciation	4.3
Cash (on hand and in banks)	1.0
U. S. Government securities	1.5
Payables (trade) :	
From business	1.0
From Government	0
Federal income-tax liabilities	2.3
Other current liabilities .....	.7
Net new issues	4.1
Total new issues	6.0
Plant and equipment	3.3
Working capital	1.1
Refunding, refinancing, etc.	2.2
Total retirements	2.5
Mortgage loans .....	.7
Bank loans (excluding mortgage loans) :	
Long-term	1.4
Short-term	1.6

* Includes depletion.

Source: Estimates drawn from various sources, largely Commerce and Securities and Exchange Commission.

in corporate securities outstanding and their ownership,

1946-47

[Billions of dollars]

	1946 ¹	1947
Net issues ¹ by industry group:		
Industrial and miscellaneous	2.5	2.0
Public utility (and telephone) .....	.3	2.1
Railroad	5	0
Net issues ¹ by type of security:		
Common stock	1.0	.0
Preferred stock .....	.3	.4
Bonds and notes	1.0	2.8
Net purchases ² by various groups:		
Commercial banks .....	.3	.2
Mutual savings banks .....	.2	.2
Life-insurance companies	2.0	3.0
Foreigners .....	.2	0
Domestic individuals, etc.	0	.7

¹ New issues less retirements.

² Purchases less sales.

TABLE 8.—Comparison of prewar and postwar relation of stock issues to total amount of new money issues,¹ 1919-47

All corporations:²
(percent)

1919-28	32
1929	62
1930-41	25
1940	42
1947	26

¹ New capital issues include issues for the purchase of existing assets.

² Excluding investment and holding companies.

Source: Commercial and Financial Chronicle.

TABLE 9.—Comparison of prewar and postwar relations of bond and stock yields
[Percent]

	Bond yields			All common stocks		
	(Moody's 120 corporate bonds)	Dividend yields	Earnings-price ratios	(Moody's 120 corporate bonds)	Dividend yields	Earnings-price ratios
1919.....	6.3	5.8	10.6	1934.....	5.0	3.9
1920.....	7.1	6.1	10.1	1935.....	4.5	3.9
1921.....	7.0	6.5	4.2	1936.....	3.9	4.4
1922.....	6.0	5.8	8.2	1937.....	3.9	4.9
1923.....	6.0	5.00	11.4	1938.....	4.2	4.3
1924.....	5.8	5.9	10.3	1939.....	3.8	4.6
1925.....	5.5	5.2	11.2	1940.....	3.6	5.6
1926.....	5.2	5.3	10.0	1941.....	3.3	6.4
1927.....	5.0	4.8	7.6	1942.....	3.3	6.1
1928.....	4.9	4.0	7.3	1943.....	3.2	4.6
1929.....	5.2	3.5	6.2	1944.....	3.0	4.6
1930.....	5.1	4.3	4.7	1945.....	2.9	3.8
1931.....	5.8	5.6	3.0	1946.....	2.7	4.6
1932.....	6.9	6.7	.7	1947.....	2.8	5.2
1933.....	5.9	4.0	3.4	1948 (January).....	3.1	5.4

Source: Dividend yields and earnings-price ratios from 1919 to 1939 are from Common Stock Indexes, Cowles Commission, Monograph No. 3. Figures from 1939 on are preliminary estimates.

The CHAIRMAN. Under your own theories, Mr. Secretary is it not essential to produce incentives for equity investment in advance of the needs?

Secretary HARRIMAN. No, sir; I do not think the present situation is dangerous. I have tried to point out this equity figure for 1947 is going to be adjusted when we know the convertibility of the large telephone issue.

In the first three-quarters of the year, if I remember correctly, the relationship of equity financing to bonded indebtedness was about the same, 32 percent, as the 1919-28 average.

Mr. MEEHAN. That is right.

Secretary HARRIMAN. The large issues, of which telephone is the important one, brought that percentage down in the last quarter.

The CHAIRMAN. As a practical matter, you think we should not make a start at restoring incentives as far as tax reduction is concerned for another year?

Secretary HARRIMAN. That would be my judgment, sir.

I want to be perfectly clear that I believe it is essential to keep a dynamic economy. When we get through these inflationary pressures we need to give real incentive for investment in equity financing, not only by total tax figures, but also in certain specific taxes.

I was asked by the House Ways and Means Committee regarding the double-taxation feature—that is, the taxing on corporate income and also on dividends. I testified at that time I believed that was a deterrent to equity financing and was one of the adjustments which should be made at the appropriate time.

I was not suggesting it for this year, however. There are other means of encouraging equity financing also, which are very important—to give incentive to management itself to give that extra effort which has made for success in the management of our business enterprises.

The CHAIRMAN. I think it follows from what you said that you do not believe we will have an important recession over the next year?

Secretary **HARRIMAN**. It is not our **responsibility**, and fortunately, not our obligation to make estimates in advance as it is necessary for this committee and the **Treasury** to do, but I see nothing in the present situation, from the analyses we have made in the Department, to indicate that inflationary pressures will not continue for the immediate future.

How long that will run, I would not want to hazard a guess.

The CHAIRMAN. I think it follows, I suggest, from your statement that we can postpone this subject for a year, that there would be no need for incentives for a year, which is another way of saying you do not believe our national income will seriously decline for a year.

Secretary **HARRIMAN**. I take no exception to that statement.

The CHAIRMAN. You are aware of the fact that the Treasury bases its estimates of revenue on a \$200,000,000,000 income?

Secretary **HARRIMAN**. I think that is the figure.

Mr. MEEHAN. Mr. Snyder testified before this committee on that.

The CHAIRMAN. What is the present level of the income figure?

✓ **Mr. MEEHAN**. The gross national product is about 240.

Secretary **HARRIMAN**. He was talking about income. What was it?

Mr. MEEHAN. \$210,000,000,000 for national income, and \$206,000,000,000 for personal incomes which I believe is the series used by the Treasury.

The CHAIRMAN. Have you had any occasion to calculate how long it takes a tax bill to really get to working?

Secretary **HARRIMAN**. It depends upon what date the Congress fixes for the tax reduction, of course.

The CHAIRMAN. I think those who work with this subject usually allow about a year for the full economic effect of tax-reduction bill.

Secretary **HARRIMAN**. Does it not depend on the date on which you fix the tax reduction? In the past, Congress has dated back taxes in both increases and decreases.

The CHAIRMAN. It would be a year after whatever the effective date was.

I am saying that many students of the subject say it takes about a year for the full economic effect of tax reduction to take effect.

So, obviously, that would be a year from the effective date of the act. There might be some aid out of a retroactive reduction, of course.

Secretary **HARRIMAN**. Retroactive payment would have probably an immediate effect. Also the individual income-tax reduction has rather a prompt effect.

The CHAIRMAN. In the light of the lag between the effective date of a tax act a year from now and the full economic effect of it, you still believe it would be safe to postpone the matter for a year?

Secretary **HARRIMAN**. I am frank to say if you reduce your taxes and withholding from employees, as soon as you institute that reduction, I think you will have an immediate effect on the amount of money that is available to be spent.

It is perfectly true some effects of tax reduction probably will not take effect for a considerable period of time, but some of it will have immediate effect.

The CHAIRMAN. I agree that some of it will have immediate effect, I think it is perfectly obvious that a considerable part of it will not have immediate effect just because of the time lags in business between placing orders and making up your mind to place orders, and manu-

facturing of goods, and delivery of goods, which take a lot of time. Is that not correct?

Secretary HARRIMAN. That is certainly correct as far as business expansion is concerned, and investment in capital developments.

I have been trying to show that we tire on a high level of capital investment at the present time, and therefore at the moment there does not appear to be any danger in that area.

Mr. CHAIRMAN. I would like to say that I, of course, am very strongly of the opinion that we are in an emergency period in this country, both in our relations to the world as a whole and in our inflationary pressures at home.

I do feel this is a very definite year of decision on the part of the American people in terms of whether they will undertake the responsibilities which I believe are in the interests of the American people in the world situation, which will require substantial sums of money.

And I do, of course, think it will add to our inflationary pressures. At home, I think we should guard against a boom-and-bust period which would have a serious effect not only upon our own position but upon our position in the world.

So, what I am saying is, in light of my feeling that we are in a very serious year in the history of our country, and therefore, I really must earnestly say I do not think it is a year to reduce taxes. I think, for one, as a taxpayer, it is better for all of us to pay our taxes for this year and to have its attendant effect of giving to the Government the money needed for programs proposed to Congress, and not to add to our inflationary pressures at home.

It will mean the deferment of the fulfillment of the desires of many of our people for many of the things they want, but in relationship to the events in the world that are taking place, I think it is wise for us to go through that period.

We are in a period that is not quite comparable to war, but we are in a period where there are definite forces at work which may well lead to this country facing a very dangerous situation in the next few years.

So, I say this because I am not dealing entirely with the economic situation in this country. Although part of it is that, the other part is the whole situation. I think we must be strong at home as well in order to face the situation abroad.

The CHAIRMAN. I agree entirely with what you said, except I do not believe you brought tax reduction into relation with it.

The great mass of people in this country, I suggest to you, sir, have homely economic philosophy and homely philosophies as to foreign affairs.

They do not go through these intricate economic minutes with which we concern ourselves with at these hearings.

If you want to sustain the things you are talking about, I respectfully suggest the best way to do it is by this dramatic way, if you please, of letting the American people know we are solicitous about their pocketbooks as we are about the pocketbooks of people abroad.

Secretary HARRIMAN. Sir, I am not interested in the pocketbooks of people abroad per se.

The CHAIRMAN. I understand that.

Secretary HARRIMAN. What I am interested in is world stability and the preservation of the free institutions which we all believe in.

If country after country gives up those free institutions we will find a situation which will be a most dangerous one.

I earnestly believe that today we can deal with these forces that are at work, but if there is a change in the complexion of the controls of large groups of people in Europe and elsewhere we will face a most dangerous situation which we may not be able to manage in the future.

The CHAIRMAN. I agree with till that, and I suggest the basis of our usefulness as far as our relationships with the world is concerned is in a sound economy, and that the sooner we can let this country know that we are taking steps to make it possible to risk capital, for example, to obtain that kind of economy, the better off we will be.

I also suggest the psychological value of giving some relief to the American people on their own tax burden is a little sign that we are solicitous about the needs of their welfare as we are about the welfare of other people.

Senator **HAWKES, Mr.** (Chairman, may I just say a word there?)

The CHAIRMAN. Yes, sir.

Senator **HAWKES.** It is said by people of experience that you can prove almost anything by figures. It all depends on what you want to prove.

I do not think anybody knows anything about what we are doing. I think it is pure, unadulterated guesswork on the foreign situation and on the domestic situation.

You will recall that we had a lot of people in here a year ago when we were considering this tax bill who were telling us we could not rely on a national income of \$170,000,000,000.

If you will go back to the minutes and see what I said there, I told you if I were going to figure it I would figure on \$190,000,000,000 or so.

The Secretary of the Treasury could not see anything like that at all.

I think we are going to have a very high national income for a long time. I do not see how you can help it.

What I mean by a long time, I think we do not need to worry about anything for a year, maybe 2 years, but nobody knows. Nobody knows about these figures that the Secretary of Commerce has brought in here, and the other Secretaries and Government officials.

They are trying to prove something that is their philosophy of where we ought to go, and some of the rest of us have ideas we are going some other way.

I would just like to say to you that the one thing that is overlooked the most by all of the people who come in here representing the different arms of the executive branch of the Government, and some of our distinguished Senators, is this: If you look at the history of the world, you will find that no nation was ever torn down in 1 year. If you will just look at it and follow it.

There has been an effort to destroy initiative and incentive in the United States for accomplishment little by little by little. I think the most important thing in front of the American people today is to show the American people their representatives in Congress and their representatives in the executive branch of the Government do not wish to use the power to tax to destroy.

I do not think there is anything so important.

I have talked with little men, and I have talked with big men, and the general import of what they said is this:

"Why should I work the way I am working if we are going to keep war taxes up in peacetime?"

"Why should I work the way I am working if we are going to try to use the funds that are taken through taxation to level the whole world off and to build our competitors up so they will be equal to us?"

Mr. Chairman, that philosophy never built the United States, no matter how kind your heart is. No one I ever knew in any business in the United States ever said, "How can I help my competitor to be as good as I am or a little better?"

I hope the American people will wake up and find out they are crushing initiative.

You take it from me, and I have talked with some very fine men in all walks of life, and they are crushing initiative. And when you get it crushed, you will have what they have on the other side of the water.

I, for one, do not want to do that. I, for one, want to keep this Nation solvent. I want to keep this Nation where it can be supreme in the air; where we do not have to say we cannot vote \$12,000,000,000 more for our Air Force to protect ourselves because we have given so many billions of dollars to somebody thinking about we do not know what, and we know not what they are going to use it for.

If I had not lived as long as I have lived in the United States and learned what I have learned about the United States and what made it, I could swing over and become one of the fellows who waves a magic wand and is going to straighten out all of the affairs of all of the people all over the world.

Mr. Chairman, this thing has been going on since long before Christ. There have been starving people all over the world, and I never can get myself to save a starving person over there because there is a million over here yelling for food, just because it is political waste or comes about from a political alliance.

I want to say one more thing and I want to emphasize it.

Mr. Harriman must know this. He is a businessman. If he does not, I will take him with me and let him talk to thousands of businessmen.

You are crushing the initiative of the American people. Your are crushing it as sure as you are sitting in this room today. People are living on their principal today.

What difference does it make if a man's income is \$100,000 a year if he only keeps \$20,000.

The immediate society around him rates him as a \$100,000 man. They expect him to contribute to charities, outside of the charity he is contributing to through taxation for the United States to be the conservator of the world. They expect him again to contribute, and I am telling you they are killing the initiative of the American people and the genius of the people who have made this country.

If Mr. Harriman does not know that, I would like to have him come to dinner some night, and I will invite 500 people and let them tell him. They would not all be rich men. I will let some little fellows tell him, too.

Secretary HARRISMAN, Senator, I am in touch with businessmen, and our business friends by and large do not agree, many of them, with my testimony.

But what I have said is my earnest conviction.

When you have got a period whose corporations are making \$17,500,000,000 net after taxes, and—

Senator **HAWKES**. May I ask the Secretary to interrupt there? Cut that in two, and take a little more off, and then you will have reality.

Secretary **HARRIMAN**. You can figure whatever way you want.

Senator **HAWKES**. You have a 40-cent dollar, and have got replacement charges.

Senator **LUCAS**. Mr. Chairman, I would like to let the witness finish his answer, if he is going to make another speech.

Senator **HAWKES**. Would the witness mind?

Secretary **HARRIMAN**. I will be delighted.

Senator **HAWKES**. I want to tell you the American people are over-looking something.

We had an explosion and a fire, and we have just replaced a building, and it has cost us over three and one-half times the cost 20 years ago, and the people are forgetting that.

I beg the pardon of the Secretary for interrupting him.

Secretary **HARRIMAN**. One of the reasons why construction costs are so high is that so many people are bidding for the available labor and material, and they are out of line with what even today should be those costs.

Senator **HAWKES**. Mr. Chairman, may I ask the Secretary how they are going to help that if they stay in business?

Secretary **HARRIMAN**. They cannot help it, but we can, certainly. I think we can help by not adding to any inflationary pressures which exist today.

If I may say this: I do not, in spite of what many of my business friends whose judgment I respect believe, withdraw what I say.

I still earnestly believe what I have said. I do not see any indication there is a diminution of incentives at the present time. There are these very large earnings of which I have spoken.

It is perfectly true that in the future, in my judgment, there must be tax reduction and tax adjustments in which depreciation allowances should be taken into account in relation to what may be the permanent base for those replacements. But I see no indication in the economy that business is not expanding at as high a rate as our economy can justify today, and we would go into a greater boom than we are in today if there were more incentives.

You may look upon our interests in the world as a humane interest. That is involved, of course, in all the people of America and what they are doing.

But I am looking on the programs which have been proposed as the basic self-interest of the United States, and I would not want to see, or be party to, policies which would turn the people of western Europe over to the domination of an aggressive force which is coming from the east.

Russia is a country of 180,000,000 people that are backward, that have no ability to produce as we or the people of western Europe have.

If you add to the domination of Russia, eastern European countries, that have higher standards than Russia but still are backward compared to the western Europe, some 80 million people, is what you have. But in western Europe, you have 260 or 270 million people who are

the most talented, **hard-working** people there are **in the world outside of this continent.**

If we do not assist in helping them preserve what we call western civilization and as the result of the forces that are coming from the east they fall under the domination of the Kremlin, we will see a change in the balance of power which is such that this country cannot readily face and hope to preserve its own institutions.

It is all very well to talk about having a defense force which is adequate, but it is utterly impossible for this country to live in an armed camp without changing our institutions.

My interest in our foreign policies is the preservation of America and its institutions.

I do share with the American people the humane desire to save people from starvation, but the basic urge on my part is to face the fact there is an aggressive force in the world and to deal with it today and not leave it until conditions are such that it is unmanageable.

I believe that is the road to peace, and I believe we can deal with it today if the policies which have been developed on a bipartisan basis have the support of the Congress and have the support of the Congress promptly.

Time, gentlemen, is running against us, and the weeks of delay are causing very serious repercussions in the world. Every week we wait the situation becomes that much worse.

Forgive me, Mr. Chairman, but the Senator made his statement, and I wanted to make mine.

It does relate to our policy, and I believe the people of this country have got to recognize, if they are to preserve the position of this country and its institutions, that we have a basic interest in the preservation of what is known as western civilization; and that we must make sacrifices today in order to avoid facing a situation which I am afraid would become unmanageable if we do not take the forward steps which have been developed by the support of both parties, and are now before the Congress for action.

Senator HAWKES. Mr. Chairman, I want to ask Mr. Harriman if he would have us proceed any faster than we have been proceeding with this European plan, and proceed without knowing anything about it, because very few people know anything about it.

I saw a poll last Friday of 6,000 farmers, and 52 percent of them knew nothing about the European recovery plan, and they are paying the tax bills the same as the rest of us.

I have always proceeded on the theory the stockholder is entitled to know something about what the directors are doing with their money.

The other 48 percent in this poll showed they knew very little about it, and yet this great body of the Senate and the Congress has not had the patience and the wisdom to say to the people on a referendum ballot—I hope they can put one on next November—the question of whether they want you and me to give their money away to the point we are doing.

The CHAIRMAN. I think, now, gentlemen, we had better proceed with the inquiry at hand.

Thank you very much for coming, Mr. Secretary.

Secretary HARRIMAN. Thank you.

The CHAIRMAN. Mr. Alvord is our next witness.

Mr. Alvord, will you give your name, address, and occupation to the reporter?

STATEMENT OF ELLSWORTH C. ALVORD, CHAIRMAN, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES, WASHINGTON, D. C.

Mr. ALVORD. Ellsworth C. Alvord, attorney at law, Washington, D. C.

I am chairman of the committee on Federal finance of the Chamber of Commerce of the United States.

Mr. Chairman and gentlemen of the committee, as I customarily do, I would like permission to insert in the record a prepared statement upon the pending bill, and then I would like to proceed with my discussion extemporaneously.

Senator GEORGE (presiding). Your statement will be inserted at this point in full, and you may proceed in your own way to develop your views to the committee.

(The statement is as follows:)

STATEMENT BY ELLSWORTH C. ALVORD, WASHINGTON, D. C., CHAIRMAN, COMMITTEE ON FEDERAL FINANCE, CHAMBER OF COMMERCE OF THE UNITED STATES, BEFORE SENATE FINANCE COMMITTEE IN HEARINGS ON TAX REDUCTION, MARCH 9, 1918

INTRODUCTION

One word sums up the insistence of every American citizen today: **Strength.** To face the future with less than maximum strength is foolhardy. I dismiss the fear that attainable maximum strength may prove insufficient. There is no solution for that. But let us ask whether we are gaining in strength, striving toward maximum strength, an ever-increasing maximum strength. If not, there is a solution for that.

Every one knows that the strength of our earned services does not stand alone; that the strength of the Federal Treasury is not measured by receipts; that our national strength does not rest upon the present strength of our military and our Treasury. Our military and fiscal strength today and for the future are no greater than the underlying strength of our country—the financial and economic and moral strength of its citizens, of industry, agriculture, natural resources, power, and transportation.

Only with strength can we meet our international obligations; maintain our national income above \$200,000,000,000; maintain annual production at about \$250,000,000,000; provide and maintain jobs and pay rolls; attract private capital into wealth-producing activities; provide the essentials of sound government; put the brakes on increasing prices and inflation; create and not kill the opportunities which have given us the strength to win two World Wars and can produce the strength needed to survive them; prevent serious reduction in our standard of living, and avoid the serious consequences of a depression.

If we are to become progressively stronger, if our paths and our policies are to lead toward maximum strength, an ever-increasing national strength for tomorrow and the future:

(1) We must cut Federal expenditures drastically each year until we have a Federal Government we can afford; anti

(2) We must reduce tax burdens this year and every year until our tax load is no greater than we can afford to carry.

In discussing the pending bill for a reduction in taxation, I shall deal broadly with four points: First, why taxes must be reduced; second, the feasibility of tax reduction at the present time; third, the form of the immediate bill; and fourth, the desirability of further revision of revenue laws at an early date.

1. Why taxes must be reduced

Adequate and convincing evidence already is before you as to the adverse effects of the present high level of taxation. Argument is not necessary on the subject. Scarcely anyone would contend that present taxes are not seriously sapping our strength and destroying initiative and incentive. Opposition to a reduction usually is based on such grounds as the alleged necessity of a high level of expenditures, possible inflationary effects of a release of more purchasing power to taxpayers, desirability of devoting all surpluses to debt reduction, and the large dollar-profits of business. None of these arguments offers a valid reason for tax burdens which are undermining and threatening our system of free enterprise.

The official budget estimates of Federal revenues run not far below the wartime peak, although higher than the 2 1/2 years ago. The higher estimates accepted by the Committee on Ways and Means are above the wartime peak of revenues. These estimates tell the story of a weight of taxation not only far heavier in any period of peacetime but little if any short of the all-time high burden upon our taxpayers. It is well in this connection to note that the revenues from direct taxes on individuals have been steadily rising until they exceed one-half of our total revenues.

Reasonable reductions of tax rates and removal of harsh and inequitable provisions of revenue laws do not necessarily or probably mean decreased revenues. Past reductions of rates have operated the other way. The reduction of surtaxes after World War I and more recent lowering of other rates produced increased receipts.

Direct taxes on individuals are estimated officially to yield in the next fiscal year about 13 times the amount of the last year before our entrance into World War II. Direct taxes on corporations will yield 4 1/2 times as much revenue. Net budget receipts will be about 6 times as great. Comparisons within earlier years would be even more striking as revenues then were considerably less than in the fiscal year just before our entrance into the war.

A high peacetime level of expenditures of course demands a high level of taxes. Some have sought to make it appear that we have done well in reducing expenditures by 60 percent from a war peak of 100 billion dollars to around 41.1 billion dollars. I would point out, however, that in a comparable period after World War I expenditures were cut by more than 80 percent from a war peak of 18.5 billion dollars in the fiscal year 1919 to 3.4 billion dollars in 1922.

True, the world situation today is much more portentous than after World War I and our obligations vastly greater. Nevertheless, there is no justification for the present level of expenditures.

Our expenditures must come down. There is widespread and justifiable belief that it is possible to cut them substantially and still meet the necessary obligations of the present period of world chaos and unavoidable domestic costs.

The current tax problem has two major aspects, one, as it creates hardships for individuals; and, two, as it affects adversely the entire economy. The two are interwoven. A tightening of the burden upon individuals would release some of the pressures which are impeding the effectiveness of our private enterprise system.

Obviously, any tax reduction measure must be designed to afford a fair measure of relief for those in the lower income classes, many of whom have exhausted their savings and are being forced to borrow to buy essential consumer goods. I do not believe that the moderate reduction in taxes which is proposed would result in an orgy of inflationary spending. On the contrary, additional funds would go to pay debts or for cash payments where buying on credit otherwise would be necessary. Considerable savings would also result. Furthermore, greater take-home pay resulting from a decrease in tax obligations would lessen the need of higher wages to keep pace with advancing costs of living. Advances in wages, involving an increase in unit costs in industry, are clearly inflationary.

The greater purchasing power for those in the low-income classes would be helpful to the economy as a whole. Scarce goods are becoming more plentiful. In many lines and the time is not far distant when manufacturers and distributors will need new markets if they are to maintain present production schedules and a high level of employment. Present heavy taxes simply do not leave a margin in the average budget sufficient for purchase of articles which have hitherto been considered necessities.

The need for tax reduction affecting those in the middle and upper income classes is extremely urgent. It is from the income of these classes that funds for investment in industry must come. The present rates of tax on individual incomes in the middle and upper brackets are so high as both to limit the amount of available savings and to destroy incentive for their investment. No one should be surprised that the source of funds for equity financing has dried up.

Present surtax rates are so adjusted that a person whose income reaches 18,000 is affected at that point by a 50 percent rate. If his income rises to 50,000 he reaches a 72-percent bracket. He needs to go only to \$100,000 to hit an 80-percent bracket. Income taxes take 34 percent of the entire income of a person at about \$50,000, 70 percent at \$150,000, 80 percent at \$400,000, 84 percent at \$1,000,000, and 85 percent at \$2,000,000. Such rates are ruinous to incentive and to equity investment.

The impact of taxation is especially heavy upon corporate income which is distributed to individual stockholders. This income is taxed twice, first at 38 percent in the hands of the corporate, and then at rates ranging from 11 to 84.45 percent, as the corporation distributes dividends to its individual shareholders.

If the individual income tax rates are applied to the 62 percent balance of corporate income after payment of the corporate tax, there is an additional tax equivalent to from 11.1 to 53.6 percent of the original income of the corporation. The total of the double tax, if assessed against the entire earnings of the corporation, would be the equivalent of from 40.8 to 91.6 percent of such earnings.

In the period immediately following the war, liquid assets of corporations were sufficiently large to provide the source for a considerable amount of necessary capital expansion. These assets have been greatly reduced with the result that there is increasing need of new equity capital and also for borrowed funds. The increase in bank credit, which is viewed as an inflationary danger, reflects in large measure a shortage of new equity capital. There would be less need for such borrowing, with its accompanying inflationary threat, if taxes on individual incomes in the middle and upper brackets were reduced sufficiently to increase the supply of savings and provide incentive for their investment in industry.

The profits of corporations, to which opponents of tax reduction like to refer, are in considerable part illusory. The high profits in dollars are depreciated dollars which have suffered in purchasing power to the same extent as the income of individuals. Inventory profits loom large in the totals but these are likely to be eaten up in replacements at current prices or otherwise disappear. Furthermore, the very large increase in sales volume has been a major factor in the increase in profits. Actually, the profit per sales dollar has been no greater than in other periods of active business. It has been estimated that a 12-percent drop in volume would wipe out till profits. These facts must not be ignored.

We have had some recent warnings in the commodity and security markets of possible downward tendencies which if continued and accelerated could change the status, overnight from one of rampant prosperity and inflation to depression and deflation. From past experience we should know that the time to check a downward turn is before it begins.

The advice offered from some quarters that we should defer a lightening of the tax burden until a business recession takes place is foolhardy. Rather, we should make the tax cut now and provide the best insurance available against a recession.

II. Feasibility of tax reduction at the present time

Your committee has been told by the Secretary of the Treasury that there is no reason to assume that either receipts or expenditures in the fiscal year 1949 will vary materially from those estimated in the January budget message of the President.

Several witnesses before your committee, however, have already pointed out the manner in which the Treasury in recent years invariably has underestimated revenues. The Joint Committee on Internal Revenue Taxation has submitted estimates of higher receipts than were accepted by the House Ways and Means Committee in connection with the pending tax-reduction measure.

Both Houses of Congress have passed a resolution to reduce expenditures by as much as 2.5 billion dollars from the President's estimates for the fiscal year 1949, and a much greater reduction is probable.

Whether or not we assume that revenues will be greater than previously estimated or expenditures reduced below the budget, taxes can be reduced at the present time without interfering with a reduction in the public debt.

It is not necessary to enter into a detailed discussion of the budget figures, which already have been fully explored before your committee.

It is sufficient to refer to estimates of surpluses. The President's budget indicated a surplus of 7.5 billion dollars in the current 1948 fiscal year and a surplus of 4.8 billion dollars in the 1949 fiscal year.

The staff experts in Congress have predicted a level of receipts in the fiscal year 1949 which would increase the surplus to 7.0 billion dollars, without any reduction whatever in expenditures. It appears probable that receipts for the current 1948 fiscal year also will exceed estimates.

Thus, in the judgment of experts whose forecasts in the past have stood up better than those of the Treasury, the aggregate surplus in the two fiscal years of 1948 and 1949 should amount to more than 15 billion dollars without any reduction whatever in expenditures.

If Congress reduces expenditures in the fiscal year 1949 by 2.5 billion dollars, the aggregate surplus for the 2 years would be at least 17.5 billion. The surplus for the 2 years may well be 20 billion dollars.

The Director of the Budget presented to your committee a rather gloomy picture of the outlook for expenditures in the fiscal year 1950. It was his view that the total in that year might be even greater than the 30.7 billion dollars in the President's budget for 1949.

I am unwilling to believe that it is necessary to spend anything like 30.7 billion dollars in 1949, or as much or more in 1950. The most effective way to stop excessive spending is put less money in the till. But even granting the validity of the viewpoint of the Director of the Budget, it would appear that the margin of receipts over expenditures would remain substantial if business should continue at a high level.

Such figures as I have cited are sufficient to show that a substantial reduction in taxes should be possible at the present time and that a reduction in the debt of 2 or 3 billions or more also can be made during the fiscal year 1949.

Larger cuts in both taxes and the debt would be assured by rigid economy at every possible point in the enactment of appropriation bills for 1949. Inasmuch as taxes, Federal, State, and local, are now absorbing more than one-fourth of the national income, they represent one of the most potent elements in the inflationary price structure. A reduction in expenditures would be the greatest possible contribution to the checking of inflation.

The theory that all surpluses should be devoted to a reduction in the public debt is completely fallacious. While a reduction in the debt is desirable both as a means of reducing the interest burden on the taxpayers and moderating inflationary influences, too rapid a program in this direction might contract credit excessively and thus have troublesome deflationary effects. Competent testimony has already been offered to your committee that a reduction in the debt by more than a few billions could be hazardous.

Furthermore, there are difficulties which make it impossible to obtain the full counterinflationary benefits from retirement of bank-held debt and accompanying shrinkage of bank deposits. The monetary supply in the form of demand deposits and currency in circulation is greater today than at the peak of the debt 2 years ago, despite a reduction of the gross debt since that time by \$25,000,000,000 and the marketable debt by \$37,000,000,000. This is due to the expansion of credit on the basis of reserves obtained by the banks in payment for maturing Government securities or for long-term securities which they have sold and the Federal Reserve banks have bought in the course of supporting the market price. An inflow of gold also has contributed to new reserves in the banking system and thus provided an additional obstacle to a reduction in the monetary supply.

Balancing the advantages of tax reduction against the difficulties and hazards attending debt reduction, it sets obvious that maximum benefits to the economy would come from a substantial cut in taxes, accompanied by a substantial curtailment of the debt.

Furthermore, those who would use all surpluses for retirement of debt forget that a recession would seriously reduce our revenues. A return to deficit financing and an increase in the debt would be unavoidable.

In fact, continuance of a high level of production is essential. Tax reduction offers the best and only insurance of an orderly reduction of the debt over the years.

III Form of the immediate tax-reduction bill

The committee on Federal Finance of the Chamber of Commerce of the United States would prefer a somewhat different tax-reduction bill than that passed by the House of Representatives and now before your committee. However, the

objectives of the bill are similar to those sought by the chamber. The lightening of the burden on individuals in all brackets is the first essential.

The chamber committee on Federal finance recently approved a report declaring that after reasonable provision for debt retirement there should be such general lowering of the rate schedule as revenues permit. It was urged that immediate action be taken to provide that the total tax liability of any individual should not exceed 50 percent of his taxable net income and that eventually the progressive rates should be lowered so as to provide a maximum aggregate rate of 50 percent, effective at \$500,000. The far-reaching effect of such a limitation as a spur to incentive and risk taking would more than offset any estimated loss in revenues.

The provision in the pending bill for an optional splitting of income by married persons in non-community-property States for tax purposes is in accord with a policy approved by the chamber. This action should be taken to remove inequity now existing between such persons and those residing in the community-property States.

There are other amendments to revenue laws which we believe are of sufficient urgency to be incorporated in the immediate bill. Among these is a reduction in the effective rate on long-term capital gains to 12½ percent and reasonable deductions from other income of capital losses in excess of gains.

We also favor immediate elimination and eventual elimination of double taxation arising from levies on earnings of corporations and dividends to shareholders. This could take the form of an appropriate credit to stockholders with respect to dividends received.

We oppose most strongly any peacetime revival of an excess-profits tax.

IV. Desirability of further revision of revenue laws at an early date

We recognize that the present hearings are devoted to proposals suitable for inclusion in an emergency bill. Hence I shall touch only briefly on the desirability of attention by your committee at the present session of Congress to the subject of a general revision of revenue laws to remove inequities of long standing and to improve administration.

We believe that it is vital that any bill for a further revision of revenue laws, which may be reported from the House Ways and Means Committee and passed by the House at this session, should receive prompt consideration by your committee with a view to final action before the adjournment of the present Congress.

For years a general revision of revenue laws has been needed. For one reason or another it has been deferred. The Treasury Department recognizes the desirability of legislation of this character and has just submitted recommendations on the subject to the House committee, some of which, though by no means all, are meritorious and should be adopted. We hope that nothing will occur to prevent enactment not only of the legislation now before you but also of a more general revision measure during the life of the present Congress.

The chamber committee has prepared comprehensive recommendations for amendments to technical and administrative provisions of revenue laws. We already have submitted these recommendations to the House Ways and Means Committee and should be glad of an opportunity to present them to his committee.

The multiple taxation of corporate profits should be prevented. The tax on intercorporate dividends should be repealed. The penalty tax upon consolidated returns should be discontinued, and their optional use permitted, and regulations consistent with time clear intent of Congress should be adopted.

Section 102 should be amended to reduce the hazards of the essential accumulation of profits. There should be a complete revision of certain sections dealing with reorganizations. The liquidation of corporations should be facilitated. The application of section 112 (f) to cases in which anticipatory replacement is involved should be assured. The existing Treasury position with respect to employee stock option purchase plans should be reversed. The pension trust provisions should be extended to include proprietors and other owners of unincorporated businesses. Revision is urgently needed of several provisions of the Internal Revenue Code, which as now interpreted, cast serious and unwelcome hindrances in the way of American-owned enterprises in foreign countries. The application of section 131 (f) (1) should be extended to domestic corporations owning 10 percent or more of the stock of a foreign corporation. The existing methods and procedures for determining depreciation deductions allowable stand in crying need of thoroughgoing revision. Provisions similar to supplement

It should be extended to all involuntary transactions, which should include all transactions necessary or appropriate to comply with regulatory statutes, such as antitrust laws and the banking laws, and with judicial decrees, administrative orders, etc. Sections 109 and 727 (g) should not turn on such technicalities as where title passes or contracts are negotiated. In the case of accumulated dividends on preferred stock or interest on securities received in a single year the tax should be computed as though the title income had been ratably received. Commercial finance companies should not be subject to the personal holding company surtax. The growth formula and substitute year provisions should apply in arriving at both constructive and average base period net income. Section 120 should be repealed. The war loss provisions should be amended to eliminate the rule for aggregation of recoveries and should incorporate the tax benefit rule, and other necessary changes. Individuals should be allowed a loss deduction for the full cost of property taken by condemnation.

Provisions limiting the interest on section 722 and carry-back refunds should be clarified to make certain that they cannot be applied to require the payment, or prevent the return, of interest on deficiencies which are offset by such refunds. Capital-gains treatment should be accorded to the receipt by an employee of lump-sum proceeds from the sale, exchange, or release of his rights to future percentage-of-income payments upon termination of employment. The statute of limitations should be amended so that the Commissioner will have a reasonable period of time after final determination of a claim under section 722 to assess any deficiency resulting from a deferment in payment under section 710 (a) (5).

The foregoing are only a few of the many technical amendments which must be made to the Internal Revenue Code.

Mr. ALYONP, I think I said that I appear on behalf of the committee on Federal finance of the United States Chamber of Commerce.

I agree fully with the statement which the chairman made during the testimony of the Secretary of Commerce that this bill is but a step toward what must be done with our tax system.

It is a constructive step and a very necessary step. I am confident that it will convince the American people that the Congress is aware that we cannot continue wartime taxation on into the third, the fourth, and the fifth year after the termination of hostilities and maintain the America which we wish to maintain.

I agree fully with the statement of the Secretary of Commerce that our first objective must be a strong United States. That we must have.

And I agree entirely with the statement of Senator Hawkes, that our present fiscal policies, including the continuation of our high wartime system of taxation, are sapping, and seriously sapping, the strength of America.

Many of the points which I would like to make I have made in the written statement which I have filed with you.

I would like to depart from that just a minute and concentrate, if I may, on the subject which was discussed at length this morning, financing American industry.

A very simple analysis gives the sources of the funds by which industry may be financed.

There are only three sources: one by obtaining money from private individuals, banks, and insurance companies, individuals outside the corporation itself, outside the enterprise itself. Persuading John Doe to turn over to you an amount and put it into the machinery of production, hoping that we can show him a profit. That is source No. 1.

Source No. 2 is the funds of the enterprise itself, its undistributed profits, its available reserves.

Source No. 3 is the Government.

Each of these three sources have been used in the past, and I am confident that this committee will insist that the third source be avoided if it is at all possible.

We can use all the statistics which the Secretary of Commerce has given you, the Secretary of the Treasury has given you, and that are in the Budget but it comes down to a very simple matter.

For example, if we turn to table 9, which the Secretary of Commerce gave you, if those figures represented figures after taxes, we would not be here today.

For example, he shows that dividend yield in 1948 for January was 5.4 percent.

I might indicate that those figures cannot possibly be figures with respect to all common stocks. I expect they are figures with respect to a so-called list of 100 industrials.

Let me analyze it just a minute.

Suppose, Mr. Chairman, you and I decided to put a thousand dollars into a corporation. The managers of that corporation convinced us that the corporation could make 10 percent on that thousand dollars and could make it with some regularity.

We would be just a little bit gullible if we accepted the regularity for the entire future, but we do see prospects of 10-percent profit. That gives us \$100.

Now let me assume that the corporation is one which will pay a 38-percent tax; \$38 of that \$100 immediately goes to the Treasury; that gives us \$62.

Let me assume, which is very contrary to sound business practice, and very contrary to accepted practice, that the corporation distributes to you and me that entire \$62.

Normally it will not. It would distribute maybe half, maybe 60 percent, and maybe 70 percent.

But for purposes of my illustration, I would like to keep it a little bit simple.

It distributes the entire \$62. How much do we have left after taxes?

The point I want to make is it is the dollars after taxes which will attract equity investment, investment in bonds, or any other type investment, just as it is on the dollars after taxes with which we support our families and our churches and our charities.

Assuming that you and I were small individuals, about \$12 of the remaining \$62 would be taken; so that 50 percent of that enterprise earnings, in case our net incomes were not in excess of \$2,000, would be taken in tax.

As we go up the brackets we find that more than 90 percent will be taken in taxes.

If we were to have \$5 left out of a hundred, or \$50 left out of a thousand, just think how long it takes us before we get our capital back.

If a minimum of 50 percent goes for taxes it would take a long time.

Exactly as you said, Mr. Chairman, it is not the \$2,000-a-year man who places his funds into productive enterprise. It is the larger income group. It must be.

So, we are faced with two situations.

First, that group which has funds for investment in productive enterprise is **dwindling** and dwindling and dwindling. In fact, I would suppose there is **practically no** one today **who**, after taxes, has money enough to invest out of the current income in productive enterprise.

Most of your investments will come **though** the use of prior years' savings accumulated in the hands of the individual.

As we go **up** into **the** higher brackets, **on** the basis of **dollar**: after taxes, I think we are perfectly safe in saying that not one single person of the United States can afford to place his funds into a productive enterprise, into equity capital of those productive enterprises.

There is not **enough** money left after taxes to justify **the** risk which **he** takes.

Someone comes to you or **me** and says: "Let me have a thousand dollars."

The first thing we ask is: "**What** chance do **I** have of getting the **\$1,000** back?"

So, the risk of the principal is one of our first questions.

And the second is yield.

I do **not** for a moment **suggest** that **the** enactment of this bill is going to entice large sums of money from individual. I think it will help, and I think it will help **solely**, as the chairman said, because **the** investors will say to themselves:

"We know that **Congress** is not going to continue confiscatory **war-time** taxes **on** wealth. We know that our **tax** rates are coming down. We know **the** Congress is going to establish and maintain a system, which is the true American system, which says that you and I can do whatever work we **want**, save some money, and invest it if we **wish**."

The evidence before this committee and before the **Committee** on Ways and Means is conclusive, and if you need more, let us just for a minute look at what we call the **smaller-business** man.

Why are there so many increasing failures among smaller businesses?

Why are smaller businesses liquidating, going out of business entirely?

Why are smaller businesses being purchased by larger businesses?

Why are there so many consolidations and **mergers**?

Primarily, because even the smaller-business **man** cannot afford to continue the risk of business based upon the dollars which **he** gets in profits after taxes.

And if our mergers and consolidations and liquidations continue, you are destroying the very basis of American life.

On top of that, you are doing more to promote **monopoly** than the Department of Justice can possibly remedy, or that **the** statutes can possibly remedy.

I am confident that the statements which have been made before your committee, in publications, the opinions of experts, cannot be controverted.

The No. 1 source of equity capital is practically dried up.

So we go to the No. 2 source.

Then, before I go to the **No.** 2 source, let me point out one fact which I think is a complete answer to the Secretary's statement this morning:

By reason of the lack of equity capital, we have seen an alarming increase within the last 2 years in bank loans, increases so alarming that the Chairman of the Federal Reserve Board came to Congress and asked for legislation giving him more control over them.

That increase in bank loans is far more inflationary than any conceivable tax reduction in the hands of the individual would be.

I do not mean to say the bill is inflationary, but I hope to clear that point up later.

But we are denying equity capital to the corporation. The corporation must go elsewhere. The one place to go is the bank, and they are borrowing from the banks. That is not too sound a procedure from every point of view.

So that we find our source No. 1 practically gone.

Source No. 2 is the funds of the corporation itself. You have a mass of statistics before you showing that the funds of the corporation itself are woefully inadequate to meet the job that must be done in the future.

If we are going to progress, and if we are to become strong, we must continue with new plants, new facilities, new equipment, extensive research and development, new products, new territories, new markets precisely as America has grown from the very beginning.

In this connection, I might say if I were to do one constructive job with respect to the use of corporate profits, I would either amend section 102 effectively so as to remove the fear of retaining profit, or lay it aside entirely for 2 or 3 years.

It frightens only the smaller man and compels him to distribute more than he should.

Use of undistributed profits is highly essential for this year and next year, and all years to come.

Now, let me assume that corporate profits, funds available within the enterprise itself, are insufficient.

We have seen that happen in the past, and we know exactly what will happen. The smaller businessman will come first because he is the man who is hurt first and will insist upon another RFC.

That man will insist upon the use of Government funds to finance him, and we all know the expected consequences of such financing.

That is the only way that business is financed—private sources outside of the corporation, and in that the available equity capital has practically disappeared.

Funds of the corporation itself are not adequate.

We either must finance industry privately or we must make up the deficiency through the Government.

In addition to the controls which the Government must impose, just think of the effect upon our surplus if we must engage in several billion dollars of financing.

I think that is the important point I desire to make.

Do not be surprised if large funds are not immediately available from private sources if the bill passes. I can assure you that practically none will be available if the bill does not pass.

I am also confident that just because the American people will realize we are headed toward a sound Federal Government, toward sound Federal financing, and toward sound taxation, a very substantial amount in the hands of the individual will be available for investment in equity capital of enterprises old or new.

Let me answer, for just a minute, if I may the comment of the Secretary of Commerce in which he states that these tremendous profits of tile corporations in 1917, and anticipated for 1948, make it inadvisable to re ice taxes.

First, as Senator Hawkes says, watch the balance sheets pretty carefully. You will find a very substantial amount of the \$17,500,000,000 so-called profits after taxes represent paper profits.

You will also find inadequate funds even at the present rate for the replacement of inventories and the expansion of business.

Let me just make one more point on that.

The most reliable estimate I have seen shows that if volume, which today is the primary factor in ~~not~~ ~~erate~~ profits, a tremendously increased volume, greater volume than we have ever had in the past, decreases by but 12 percent, all corporate profits are wiped out.

Let me discuss now the issue of inflation and its relation to tax reduction.

I am convinced that tax reduction in this bill, or a greater tax reduction, which I hope will be forthcoming next year, will have definitely no inflationary effect.

It seems to me that the argument of the Secretary of Commerce was somewhat like the argument which the administration representatives made back in 1942 about the so-called inflationary gap.

That concept of an inflationary gap^a was busted exactly 100 percent within a few days after they came out with it, and this is the first time I have heard an argument which smacked of the same inflationary-gap concept.

Let us take the smaller-income group. We know that today a large number of the smaller-income group do not have enough money left after taxes to pay living expenses and to buy those things which they want, which we in America believe are necessary.

They are borrowing for it. Obviously, the relief which they get in this bill will go in large part to pay off debts and in large part to avoid debts. It is not going to stop the buying or increase the buying.

A large part will go into savings.

The CHAIRMAN. Is it not obvious that if you buy out of the proceeds of a loan you are spending money just the same?

Mr. ALVORD. Just the same precisely, Senator, and you are increasing bank deposits.

Bear that in mind.

I might even take one more step. The spending of \$40,000,000,000 a year is more inflationary than all the tax reduction you could conceivably give.

The CHAIRMAN. You probably observed that Secretary Harriman admitted as far as incentive capital is concerned, people buy just as much goods with money they borrow at the banks as they would with equity capital.

Mr. ALVORD. Yes, sir.

The CHAIRMAN. So the inflationary angle disappears as far as that is concerned.

Mr. ALVORD. It does, and I am glad you have reached that conclusion because it is the only conclusion which conceivably can be reached.

Let me mention for just a minute the argument that funds must be used to retire the public debt.

I do not want to get into an argument upon statistics, **except to say probably the estimates we made last year were quite a bit more accurate than those the Treasury made.**

I think the estimate which Mr. Stain and his joint committee made, which are in the House-committee report on the pending bill, are far more correct, and have proved to be far more correct than the estimates of the Treasury.

But, in any event, we have for the years 1948 and 1949 a minimum of \$16,000,000,000, and probably as much as \$20,000,000,000, available for debt reduction or tax reduction.

I cannot believe that people who are familiar with the fact of the reduction of the public debt are going to insist that 16 to 20 billion of the debt be reduced in 2 years.

I should think they would be much more interested in making certain that we maintain a national income in excess of \$200,000,000,000 and maintain a national output of \$240,000,000,000 to \$250,000,000,000 so that we will have resources with which America can amortize our public debt in a sensible, orderly way, and at the same time reduce taxes.

If those who insist upon reducing the public debt would realize the effect upon the public debt of merely a slight recession, or even a more serious depression, with all the effect upon our receipts and at once current effect upon the demand for expenditures and upon our expenditures, they would, I say, argue not for a 16 to 20 billion dollar reduction, but for a sound and sane America under which the public debt can be properly controlled and managed and paid.

The House bill does not go nearly as far as we hoped it would.

I think if the two bills last year had not been vetoed, we would have had another tax-reduction bill this year which would give us still a further step toward a peacetime tax system.

The CHAIRMAN. It is apparent now, I suggest, that we could have had a reduction last year and would have had the surpluses which we predicted at that time.

Mr. ALVORD. Without any question, Mr. Chairman.

As a matter of fact, I am tempted to cite your estimates as rather conservative.

You will recall and I am relying on my memory only—that the Secretary of the Treasury was insisting on a national income of \$167,000,000,000 for the basis of his estimate. And I think you said, "Suppose we go to \$175,000,000,000 or \$180,000,000,000."

Now, our national income is at a very definite trend upward which, as far as I can see, is continuing and will continue throughout 1948. It is \$210,000,000,000 now as compared with \$202,000,000,000 just a few months ago, and I see no signs at all of the curve starting the other way. This is the basis of the estimates in the committee.

I think they are rather conservative in suggesting that we will have an average in the year 1949 of \$200,000,000,000.

I think you are going to have more than that.

So I think their estimates are probably low.

If I were to leave one message with you, it would be to insist this bill is followed by other bills.

Corporate taxes must be reduced.

Double taxation of corporate profits must be eliminated or at least alleviated.

We must remove the penalty upon consolidated returns and eliminate the tax on intercompany dividends.

The capital-gains tax is far too high. It must be reduced, and the corporate income rate I trust, next year will come down to 33 percent together with more relief in the hands of the individual.

I would like to see in this bill, and I am confident it will cost nothing in revenue and the stimulus will be tremendous, the very simple rule which I think the American people would accept without question: No person should be compelled to work in peacetime for his Government more than half his time.

Write a 50-percent ceiling into the bill, and then you will see some effect on risk capital and effect on enterprise and on initiative and on ambition.

I think the spur resulting will far more than offset any estimated losses which probably would lie somewhere between \$200,000,000 and \$300,000,000 on paper.

I want to go outside the bill for just a minute, if I may, to impress upon you the importance of that which must be done.

Taxpayers have been promised a revision of the administrative provisions of the internal-revenue code for years and years and years. And it has never been forthcoming.

A bit here and there, quite true, but a real job has not yet been done.

The chairman of the Committee on Ways and Means has assured us there will be a second bill this year which, I trust will deal with the reorganization provisions and make them workable, the liquidation of corporations, and personal holding companies, and make them workable; a large number of things, many of which are in the so-called Magill committee report, and others in the record of the Committee on Ways and Means.

If the Committee on Ways and Means passes that bill, I trust this committee will take immediate action on it and be sure it is enacted before the end of this session of Congress.

There is one item I might mention to you, which I think could well be attached to one or more of the smaller bills pending before this committee without necessarily attaching it to this bill.

A bill passed the House just the other day affecting the revenues.

It is very important and not too technical a matter.

Come back to section 722. I am going to talk on behalf of the Commissioner on Internal Revenue.

You will recall under section 710 under certain circumstances, by virtue of reduction of taxes under 722, you could defer payment of a portion of taxes.

Now we are up against a peculiar situation. If the Commissioner acts on 722, and a loss is less than the deferred payment, or if he denies the entire claim, the statute may run on collecting the amount of the deferred tax.

Statutory provision would be quite simple, but the Commissioner should be given power to assess the amount of the deferred tax, notwithstanding his action on 722 and notwithstanding the running of limitations on the so-called standard issue.

I think that is rather important and I hope the Treasury will urge you to include it in the first bit of legislation in which some of these administrative things can be included.

Let me sum up generally.

If we are to step firmly and insistently toward this strong America, I want to urge two things. These are not the only two things, but we are talking only on fiscal matters today.

I would like to urge two things: No. 1. Reduce expenditures drastically below the \$40,000,000,000 level.

Federal fiscal strength requires a lower level of expenditures—and this means (a) a determination by the Executive to curtail; (b) closest scrutiny by the Congress of each and every proposal, and the adoption by the Congress of more effective controls and procedure; (c) a scrapping, at least for the present, of all new, nonessential functions; (d) a refusal to expand existing functions; (e) a postponement of authorized projects, insofar as possible; (f) a thorough review of our grants-in-aid policies and practices; (g) a business-like reorganization of our Government, to eliminate waste and duplications; (h) an increase in the efficiency of Government personnel by placing appointments and promotions upon merit and not upon politics and political contributions; and (i) we must learn to live within our income, and within a moderate income.

Expenditures can and must be reduced. We are not a \$40,000,000,000 Government unless we do it through the inflationary processes that everybody dreads.

Two: Enact the bill before you, and each year so far as you possibly can continue to cut taxes until we get a total tax load which the American people can afford to carry.

The CHAIRMAN. Any questions?

Senator GEORGE. No questions.

The CHAIRMAN. Thank you very much.

Mr. ALVORD. Thank you, gentlemen.

The CHAIRMAN. We will meet at 2:30 in the District of Columbia committee room in the Capitol.

(Whereupon, at 12:55 p. m., the committee recessed to reconvene at 2:30 p. m., in the District of Columbia Committee room, this same day.)

AFTER RECESS

(Thereupon, at 2:30 p. m., at the expiration of the recess, the committee reconvened in the District of Columbia Committee room, Capitol Building.)

The CHAIRMAN. The committee will come to order.

Is Mr. Button here?

Mr. BUTTON. Yes, sir.

The CHAIRMAN. We are taking you somewhat out of order, Mr. Button. Mr. King, who was to proceed you, has not arrived.

STATEMENT OF RALPH W. BUTTON, ON BEHALF OF NATIONAL RETAIL DRY GOODS ASSOCIATION

Mr. BUTTON. Mr. Chairman, and members of the Finance Committee, my name is Ralph W. Button. I am employed as manager of the Tax Department and am Assistant Secretary of Allied Stores Corpo-

ration. I am a member of the Federal Tax Forum. I have written several articles on taxation and for many years my activity has been entirely within the orbit of taxation.

I appear before this committee as a member of the taxation committee of the National Retail Dry Goods Association, by which I have been authorized to make known the views of that association and its membership with respect to H. R. 4790.

The National Retail Dry Goods Association is a trade association whose membership represents upward of 7,500 retail stores throughout the United States and its Territorial possessions. The annual sales of members of the association aggregate over \$10,000,000,000, which is about 10 percent of all retail sales in the United States, including food and automobile sales. Seventy-eight percent of the sales of the members of the association are made by small stores at the community level.

In number of stores and in amount of sales, the small retailer far outranks the large retailer. The number of persons employed by our membership exceeds 600,000. Our member stores serve every type of community in the land and our membership's opinion is truly representative of the views the citizens of our Nation have with respect to the legislative proposals before your committee.

The taxation committee of the National Retail Dry Goods Association has functioned for more than 27 years with unusual continuity in its membership and during that time has consistently adhered to the policy of making such fiscal recommendations to congressional committees concerned with national revenue as were calculated to serve the best interests of the whole economy rather than the interests of any special group.

We are completely in sympathy with the basic principles which underlie H. R. 4790 and, with the reservations hereinafter noted, support the bill and recommend its enactment into law. The bill, in our view, is a step toward the achievement of reform long needed in national taxation.

It is considered opinion of the taxation committee of the National Retail Dry Goods Association that the type of tax program which would best serve the needs of the Nation at this time is one which provides for—

1. The essential functions of the Government;
2. A strong and adequate national defense;
3. Provision for the retirement of the national debt;
4. Implementation of the national foreign policy; and
5. Encouragement to the domestic economy as to assure the achievement of our national welfare.

To accomplish these objectives, Federal expenditures must be drastically curtailed. Areas of inefficiency, duplication of functions, and inconsistency existing in the administration of national affairs must be eliminated. The Government, our biggest business, must operate at least with the efficiency demanded for the survival of any business enterprise.

Above all, to achieve such ends, the Federal Government's power to tax must now be so wisely exercised as to bring about greater productive effort and cooperation by all our people to preserve our very national existence.

It is acutely recognized that there can be no substantial reduction in the Nation's tax bill unless the level of Federal expenditures is drastically reduced. Federal expenditures must be cut.

In this connection we recommend to your committee the budget analysis prepared by the Committee on Postwar Tax Policy appearing in their booklet entitled "A Tax Program for a Solvent America (1947)," which presents a budget of \$31,577,000,000, indicating a possible reduction in the President's budget of approximately

A reduction of at least \$3,000,000,000 in the President's budget appears to be definitely possible. Reduction in the budget is the job of Congress. It is no easy task. Entrenched bureaucracies will be loud in their protests and in their demands for the maintenance of planned expenditures.

Congress, as the elected representative of the people, must determine what are the essential services of the Government. All overlapping and wasteful activities can be eradicated only if Congress strikes at the cause by cutting appropriations demanded by the Government's departments and by reducing tax revenues.

We have specific recommendations which we respectfully submit in the earnest belief that they will be of assistance in formulating a sound tax program. Our recommendations will specifically indicate a few points with respect to which our views differ from those contained in H. R. 4700 and the reasons for such divergence.

The individual income tax: The high tax rates presently in effect with respect to individual's income has a repressive effect upon production, in addition to being a deterrent to the development of new enterprises.

We in the retail field have long been hopefully looking forward to a reversal of the conditions which exist in the markets. We had hoped that markets characterized by scarcities and inflation, by shoddy and inferior goods and by perpetual shortages, would be relegated to the past.

Instead, however, more and more frequently we are confronted with the unassailable fact that it is economically unsound for manufacturers of many commodities to produce needed goods to the uttermost of their capacities.

To achieve the volume of production necessary for our domestic economy and for the requirements of our foreign policy requires two- and even three-shift plant operations in many productive industries. Accelerated operations take their toll not only of human energy but of the machines and tools with which industrial plants are equipped.

If the only reward which such activity, though sorely needed for the support of our standard of living and for the safety of our economic structure, is what virtually amounts to a confiscatory levy, it would be unreasonable to suppose that the effort will be put forth.

Taxes at present rates penalize productivity of labor, management, and capital. The continuance of the philosophy which underlies our present tax structure augurs ill for the future of the country. A study by the Reverend Edward A. Keller, C. S. C. for the Bureau of Economic Research of the University of Notre Dame, in an article entitled, "Who Gets Our National Income," published in Look magazine, March 16, 1948, simply described this evil.

He points out that:

The American worker gets the tools he uses from individuals who do not spend all of their income for consumer goods and services, but save part of their income and invest it in tools.

In this country, most of the tools were accumulated in the 30 years prior to 1920. During the period 1920-30, the period of greatest expansion in new and better tools, new capital issues average \$6,000,000,000 dollars a year.

Most of the savings which made possible these new and better tools, came from those in the income bracket of \$5,000 and over. This was possible because the Government did not take their savings in taxes, but permitted these savings to be invested in business.

In 1933, however, a new tax policy was adopted in this country. It was based on the mature-economy and planned-scarcity theory, which maintained that our national economy had too many tools due to a maldistribution of national income by which too much income went to the upper classes, and therefore into savings and not enough into purchasing power.

In line with this theory, the Government adopted the policy of taking in taxes a large part of the savings of those in the income bracket \$5,000 and over, and especially those in the income bracket \$25,000 and over.

Funds, therefore, were simply siphoned from the private-capital market to the Government. Private investment practically ceased. From 1933 to 1945, new capital issues averaged less than half a million dollars a year.

For the first time in our history, during the period of 1930-40, our economy went backward instead of forward.

The national tool account (capital) fell 19.4 percent from 1930 to 1940. Those who suffered most were the workers, because the result of such tax policy could have been nothing but continued economic stagnation.

This actually was the case. Evidence is the fact that in 1940, after Government expenditure of these savings taken in taxation, the country was still in depression. And there still were 7,000,000 workers unemployed.

It would have been much better if these savings had been permitted to remain in the hands of individuals, to be used to create more and better labor-aiding tools—the vital ingredient of our unmatched standard of living.

Today the former exponents of the planned-scarcity economy have shifted ground completely; they now advocate an expanding economy, for example, labor's demand for increased steel capacity.

Unfortunately, they do not say where the funds will come from for this "expansion for full employment." They advocate continuance of the extremely high income taxes on those incomes which in the past have accounted for new tools. And they also demand an increasing share of profits which today are the important private source of new tools. Therefore they logically must advocate that business expansion be made from Government funds.

This is socialism. One need look no further than Great Britain and France to see what that kind of socialism has done for the working people.

It is most important that immediate action be taken for the reduction of taxes on individual incomes. The tax rates on all income groups should be reduced but with particular emphasis on the tax rates applying to incomes below \$4,000.

The percentage reduction set forth in H. R. 4790 is acceptable as a start in the direction of lower personal income-tax rates. Eventually the highest rate in the top bracket should not exceed 50 percent.

We urge that the specific exemptions remain at the present level—that is, \$500 for each taxpayer and dependent. H. R. 4790, title II, section 201, paragraph (1) (a) increases the personal and dependency exemptions to \$600. The increase of only \$100 in such exemptions results in an estimated reduction of \$2,010,000,000 (see table XII, Ways and Means Committee report). It is further estimated that approximately 3,500,000 persons will be eliminated from the tax rolls.

We firmly believe that the income tax should be levied on as broad a base as possible. All of the people should be conscious of our fiscal and economic problems. All who enjoy the freedom of liberty afforded

by our system of Government should bear some of the burden of that

There is a definite need for the awareness of the cost of Government services. The removal of 3,500,000 taxpayers from the tax roll destroys the citizens' sense of responsibility and interest in the efficiency of their Government.

We strongly recommend the adoption of title III of H. R. 4790 relating to the income-tax determination of husband and wife. The eradication of the inequality created by the favorable tax treatment of husband and wife in community-property States is long overdue. In a democracy, all contributors to the revenues of the State should be treated exactly alike regardless of the place they may happen to live.

While it is beyond the scope of our testimony as permitted by this appearance the members of the National Retail Dry Goods Association firmly adhere to the belief that several additional revisions in the tax structure should be considered in the interest of a sound fiscal program. **The corporate income tax:** We are not recommending any reduction in the normal and surtax rates on corporations at this time. While we believe that corporate rates are too high, revenue requirements will not permit a reduction in both personal and corporate rates.

It is hoped, however, that in the near future it will be possible to reduce corporate rates and to introduce a system whereby the double tax on corporate net income is eliminated.

There are, however, certain revisions of the income-tax law which should be made at this time.

(a) The 15-percent tax on dividends received by one domestic corporation from another should be repealed. The taxation of inter-corporate dividends represents triple taxation of the same income.

It is often necessary for corporations to organize and do business through subsidiary companies. The tax laws should not discourage the expansion of business enterprises in this manner. The dividends received eventually flow to the stockholders as dividends.

(b) We recommend the elimination of the 2-percent penalty for filing consolidated income-tax returns. There should be no penalty for an integrated business filing one return. A consolidated statement of accounts is recognized as essential for the proper presentation of the operating results of a particular business.

(c) There has been and is a great deal of confusion concerning the administration of section 102. Many small businesses depend largely upon the retention of earnings for plant expansion and improvement, development of new products, and the creation of reserves to provide for lean years.

The fear of section 102 has caused many boards of directors to pay out more dividends than they honestly should. The managers and directors of corporate enterprises are the best judges of the needs and future needs of the business. A revenue agent in the field cannot be the best judge. Under the present law, the burden of proof is upon the taxpayer to prove that earnings and profits were not improperly retained.

We urge that-

1. The burden of proof should be upon the Commissioner of Internal Revenue that profits have been unreasonably accumulated.

2. The tax should **apply** only to that part of section 102 net income which **has** been unreasonably accumulated.

3. Dividends paid **within** 75 days after the close of the taxable year, may, at the taxpayer's election **be** deducted **in computing** section 102 net income for such year.

(d) It is recognized that with a budget **minging** into the \$30,000,000,000, that excise taxes are a necessary part of our tax structure. Nevertheless, we believe that it is **feasible** and possible to return to the status of excise taxes existing before 1942, except for taxes on tobacco and alcoholic beverages.

(e) We place particular emphasis on the repeal of the tax on transportation of property. This particular tax is **pyramided** many times throughout the distribution system. This tax enters into the cost of the real necessities of life such as food, fuel, and clothing. It is another item in the high cost of living, the repeal of which would **enure** to the benefit of the consumer. We, therefore, recommend that excise taxes be reduced to the rates **in effect** prior to 1912 except for tobacco and alcohol.

(f) Under the present law, net operating losses in any one year **may** be carried back and applied against the two immediately preceding years and the balance of the **unapplied** loss may be carried forward for two immediately succeeding years.

We recommend **that** the net operating loss carry-forward be extended to 5 years and the net operating loss **carry-back** be discontinued. The determination of tax liability for both **the** taxpayer and the Government is difficult since past **tax** years must be kept open for long periods of time.

Conclusion: The enactment of H. R. 4790 into law with modifications we urge upon your committee will encourage our people to put forth **greater** productive effort so urgently **needed**. It will release to **creative** purposes wealth and energies which have been heretofore forced into nonproductive channels.

We hope that this bill is but the first step toward the achievement of a sounder fiscal policy than the one we **ha**e pursued for the last 16 years. We also hope that the enactment of this bill into law will quickly demonstrate **the** national advantage of policies which encourage the creation of wealth **by** releasing and stimulating venture capital.

We confidently anticipate the benefits which will ensue from the enactment of this bill will clearly point **up** the wisdom and feasibility of further tax reduction.

The CHAIRMAN. Are there any questions, Senator?

Senator GEORGE. You say you would relieve 3,500,000 there. The increase in deduction will relieve about 6,500,000. But that does not **argue** against your point; it argues for it—

Mr. BUTTON. That is right.

Senator GEORGE. The fact that there are more.

Mr. BUTTON. I did not see any publication of the number of people that would actually be reduced.

Senator GEORGE. About 6,500,000.

Mr. BUTTON. I made a mathematical calculation of my own as to the possible number.

The CHAIRMAN. Thank you, very much.

Mr. BUTTON. Thank you, sir.
(Exhibit A is as follows:)

EXHIBIT A

TABLE VIII.-A *reduced Federal budget for 1948*

Class of expenditure:	Amount
National defense.....	\$10,000
Veterans' services and benefits.....	7,000
International finance.....	2,000,000
Social welfare, health, and security.....	1,500
Housing and community facilities.....	358
Education and general research.....	8
Agriculture and agricultural resources.....	75
National resources not primarily agricultural.....	800
Transportation and communication.....	1,000
Finance, commerce, and industry.....	112
Labor.....	104
General government.....	1,000
Interest on the public debt.....	5,000
Refunds.....	2,005
Total expenditures.....	31,577

NOTE.—Reprinted from A Tax Program for A Solvent America (1947), p. 50. by the Committee on Postwar Tax Policy.

The CHAIRMAN, Dr. Halvorson? Will you give the reporter your full name, address, and occupation?

STATEMENT OF LLOYD C. HALVORSON, ECONOMIST, THE NATIONAL GRANGE, WASHINGTON, D. C.

Mr. HALVORSON. I am Lloyd C. Halvorson, economist of the National Grange. Our office is at 744 Jackson Place NW., Washington, D.C.

Because Grange members realize the tremendous significance that the fiscal policies of our Government have to economic stability and economic progress, they have given considerable thought to proposals for tax reduction.

Part of the reason why Grange members have such a great interest in fiscal policies is that they have concluded from their past experiences that general prosperity is vital to agricultural prosperity.

It is very difficult to greatly affect the percentage of the national income that goes to agriculture. This being so, it is clear that we must give considerable thought to policies that can promote economic stability and that permit maintaining a high or an expanding national income.

At this point I want to add that a collapse in farm prices, if not prevented by support floors or otherwise, could precipitate a depression just as easily as unsound fiscal policies.

Farmers are probably the chief victims of economic instability. In periods of depression their prices fall the lowest. Not only do they lose their current income, but in many cases foreclosures take from them what little they have been able to accumulate from a lifetime of hard work.

Sound fiscal policies hold out to farmers the greatest hope of economic stability. Fortunately, fiscal policies to promote economic stability are entirely consistent with our principles of free enterprise.

But that is not all. If we do not use fiscal policies to promote economic stability we are threatened with a host of measures providing for direct governmental intervention.

All periods of inflationary danger, even in peacetime, 2½ years after the end of the war, we are threatened with such things as price control and rationing. In periods of depression the threat of direct governmental controls is even greater and more insidious. Unless we promote economic stability by every means possible our whole foundation of free enterprise will be seriously threatened.

Grange members saw during the war how huge budgetary deficits poured an excessive amount of purchasing power into our economy. Prices rose to such a high point that we attempted to hold them in check by price controls.

For 2½ years after the war this excessive purchasing power has continually threatened us with further inflation, in spite of the fact that production of goods and services has been at unprecedented levels.

A budgetary surplus just the opposite of a budgetary deficit drains off purchasing power from the economy. If the budgetary surplus is used to retire Government bonds held by commercial banks it serves to contract credit and has the effect of actually extinguishing money, that is, demand deposits.

In view of these facts, Grange members have come to certain conclusions. They are overwhelmingly, and with strong conviction, opposed to any general income-tax reduction at the present time, and as long as inflation is with us. In other words, we favor the largest possible budgetary surplus to retire Government debt under present tax rates and rigid governmental economy. It is high time, 2½ years after the war's end, that we settle down to affirm and stable price level if we are to maintain a stable and prosperous economy for years to come.

It is frequently said that no one is really concerned with inflation. If this philosophy holds sway, there will someday be a rude awakening and a reexamination of the past.

Grange members have another reason of equal importance with that of economic stability, for opposing tax reduction at this time. If we are ever to reduce our national debt, we must do so in periods of prosperity. It is a happy coincidence that fighting inflation by fiscal measures is in perfect harmony with our desire to reduce the national debt.

Unless we reduce our national debt now when we can, our Government may face a dire crisis when and if a depression should come upon us. If doubt should ever arise as to the ability of our Government to meet its obligations, it might mean the downfall of our form of government. Certainly it would mean disastrous inflation or repudiation.

Should a depression come, it is likely that there will be need for deficit financing. The more we reduce the national debt now the stronger the position of our Government regardless of what the future may hold for us.

Even if we should reduce the national debt at a rate of 5 billion dollars every year it would still take more than 50 years to retire it. Judging from last experience, we know that deflation or low prices is our problem about half of the time, and in these years the rate of debt retirement will be greatly reduced as it should be.

Furthermore we know that even in some peacetime years we may add to our national debt, as we did in the 1930's. And while we hope

for the best in our world affairs, we must be prepared for the worst. All this means that we should reduce the national debt as much as we can now while economic conditions are such as not only to permit it, but also are such as to demand it from the standpoint of sound national economic policy.

While we are concerned with the broad economic aspects of tax on taxes are still taxes and Grange members do not like high taxes. There can be no stronger desire for low taxes than that which comes from our members. They not only dislike high taxes but they also dislike big Government. While we dislike high taxes, we possess enough perspicacity to know that there is a difference between taxes which go to increase governmental expenditures and high taxes which go to reduce our national debt. Taxes to reduce the national debt now are a lessening of an inescapable burden for the future.

It is a reduction in governmental expenditures rather than of taxes which will increase the supply of private goods and services available to our American consumers. A reduction in governmental expenditures would not only release men for employment in private enterprise, which would be reflected in an increase in the national output of goods, but it would also reduce the demand for goods in short supply.

On the other hand, as long as we maintain maximum production and maximum employment, high taxes to be reflected in a large budgetary surplus will not reduce the availability of consumer goods and services.

It is very important for the future of our country that all our citizens recognize these differences between high taxes which go for governmental expenditures and high taxes which go to reduce our national debt.

Many people are inclined to think: "If my taxes were lower, I could buy this, or the other thing." In individual cases this might be true, but if tax reduction, as distinguished from reduction in governmental expenditure does not increase overall national production, then on the average, consumers would not be better off, because prices would simply rise. Creditors would lose and debtors gain.

More farmers are paying income taxes today than ever before. After a decade of eager subsistence in the 1930's they are now able to make some financial progress. While our members recognize that farm prices and good crops may not last long, they nevertheless favor high taxes for debt reduction now. If their philosophy was that of letting others and their children pay the debt, they would favor tax reduction.

Some time in the future will our economy settle down to a stable basis, we will want and we will need to, reduce taxes and the budgetary surplus. It could be that within this next year our level will change from inflation to deflation.

However, if we will need to have a price adjustment in lines where prices are too high, and even if prices would generally come down in all lines, it would be a good thing for us to the point where production and employment began to fall off. Should this happen, we would favor some tax reduction this year.

We think this is very unlikely, but we favor setting up a modest tax-reduction program to become effective in an employment should fall below 95 percent of the labor force this year.

At the present time we believe it is unsound procedure to reduce taxes before the total of governmental appropriations are known. We believe that experiences of last year demonstrated that it is impossible in ties like these to set a budget ceiling and stick to it.

If taxes were reduced 6.5 billion dollars as some advocate, and if the Congress failed to reduce the President's budget which allows only a 4.7-billion-dollar surplus, we would have a budgetary deficit of 1.8 billion dollars: something which I am sure that even the advocates of tax reduction would not want to see. It must be kept in mind that the President's budget did not provide for my pay increase for Government employees, and there is some indication that there is an increase in the office.

It would be much wiser, in our opinion, if Congress would first establish the desirable amount of budgetary surplus for next year. This figure would then be added to the total governmental appropriations to automatically determine the tax rates at the end of the year.

We note that some witnesses must have put much emphasis on the necessity of tax reduction, particularly on the higher incomes, to provide venture capital.

One big reason why capital is at times afraid to venture is fear of the future. Fear of depressions and governmental controls appear to be two basic elements. At times, monopolistic elements which prefer a big profit on a small volume to a smaller profit on a large volume, retard expansion.

It is very doubtful that any serious deficiency of funds for capital expansion exists today. Latest figures show that nonfinancial corporations today hold 34.7 billion dollars of liquid assets without including inventory. Unincorporated business holds another 27.2 billion dollars making a total of 61.9 billion. In 1939 the total was only 17.6 billion.

In 1947 new investment in plant equipment and inventory amounted to over 25 billion dollars. In 1947 corporate profits reached a new high and although dividend payments also reached a new high, corporations retained five-eighths of their profits to plow back into the business. Retained corporate earnings were double those of the war years and four times those of 1929.

The tendency toward borrowing rather than financing through stock issues has probably been called to your attention. This is usually presented as evidence of a shortage of equity capital.

Actually, however, it may only reflect a desire of business to concentrate the profit upon fewer shares. Stockholders are frequently opposed to dilution of the equity. If money can be borrowed for 3.5 percent, and 15 or 25 percent earned on it, borrowing from banks or selling bonds is probably logical.

At this point I would like to point out that a uniform reduction in taxes—which would otherwise go into a budgetary surplus—might not increase savings as much as some may think. If tax rates were reduced from 20 to 10 percent of my income I am no better off if prices rise 10 percent as a result of the increased purchasing power made available, nor would my savings necessarily increase.

If there is great room for capital expansion in our economy, as we hope there is, let us not try to bring it all about at one time.

It is a **well-established** economic theory that business cycles are caused by **an unevenness** in the rate of capital formation to **promote** economic stability. Capital formation should be **spread** out over many years to come.

It appears to **us** that the greatest limiting factor to capital **expansion** today is the availability of men and materials. We are not **impressed with** wild statements to the effect that **reduced** tax rates would encourage such an expansion **in industry** that **the** additional income would actually increase tax receipts in **the** light of the fact that **business** is today more prosperous and making more money than, ever before, and those who can get the location, the equipment, the **material** are already going into business as fast as they can.

We have **used** our **time** mostly to speak on the matter of tax **reduction**. The tax policy of the National **Grange** also covers other aspects of governmental expenditures and taxation. We hope you gentlemen will read appendix **A**, containing the full tax program of the **National Grange**. Also appendix **B**, which presents **the** remarks Mr. **Gos** made on taxation **in his** masters' annual address to **the** delegate body of the National **Grange** last November.

Three points in the **Grange** tax program need special mention. We believe that the **best** way to reduce taxes would be to make a **uniform** point reduction **in** the tax rate at all income **levels**. For example, the tax rate at **all** income levels could be reduced five points.

We believe that as many citizens as practicable should pay direct taxes **in** order that they be fully **aware** that governmental **appropriations** is money out of their pockets. I might **add** we oppose any increase in exemptions.

Another part of our tax policy calls for equality in Federal income taxation between those States which have community-property laws and those which do not. Permitting splitting of income **accomplishes** this though it does reduce the tax revenue **from** the higher income **levels**. However, this method is probably the only feasible way of achieving equity in this situation.

To discourage corporation farming and absentee owners from **acquiring** large acreages of farm land for the purpose of deducting losses incurred in farming from income from other **sources**, we urge that **the** tax law be **so** written as to permit deduction of losses **on** agricultural operations only from income derived from such agricultural operations.

In conclusion, **we** urge that no reduction in income taxes be made as long as inflation is with us. We agree with **the** observations of Professor Groves, of Wisconsin, that taxation has **been** elevated from the position **of** a mere Government meal ticket to **an** instrument of grand economic strategy.

(Appendixes A, B, and C follow:)

APPENDIX A

REPORT OF COMMITTEE ON TAXATION

Today the total annual tax bill of the Nation for all levels of government is over **\$50,000,000,000**, or about **one-fourth** of our national income. This is a per capita cost of government **of over \$350**. In establishing our policies in regard to public finance, it is important that we take note of **the increase in** the cost of government as indicated below:

Per capita cost of government

1801.....	\$12.50	1930.....	\$89.70
1902.....	17.05	1940.....	135.79
1913.....	27.32	1947.....	350.00
1923.....	74.00		

In our fiscal policies we also must take cognizance of the fact that our Federal debt is today about \$250,000,000,000. Interest on this debt is approximately \$3,000,000,000 a year.

It is evident that public finance has attained such proportions that today unsound tax policies could easily cause booms and busts, very more serious is the fact that today unsound tax policy could bring to us the despair of economic stagnation, the chaos of inflation, the defilement of the integrity of the national debt, and, worst of all, the fall of our form of government and our ideals.

It is for these reasons that we strongly endorse the words of the national master when he says, "It would be more statesmanlike if those who tire doing so much talking and making so many promises to cut taxes would turn their energies to cutting expenditures and reducing our debt. Cutting income taxes has a strong political appeal among a limited group, but it would be far bitter to pay our debts while we are able to pay and reduce the dangerous inflationary pressures we are under, rather than to increase such pressures, and cutting taxes instead of debts would do."

Because of the tremendous importance of sound tax policies to our national economy and our form of government, every group in America should take upon itself the responsibility of bringing to its members the opportunity to understand the workings of taxation in our economy. Then every citizen would be able to judge for himself whether a certain tax proposal would damage or improve the performance of our system. This is the only safeguard against acceptance of specious arguments and public response to irresponsible political appeals. Our ability to establish such a safeguard may well be the real test of our democracy.

At this point we gain quote the national master: "Wild statements that reduced taxes would encourage such an expansion in industry that the additional income would actually increase tax receipts are not impressive in light of the fact that business is more prosperous than ever before, and those who can get the location, the equipment, the material, and the labor are already going into business as fast as they can." Any increase in the national income that might result from lower taxes would be in dollars and only to a negligible extent in goods and services produced—plainly more inflation.

GOVERNMENTAL EXPENDITURE

Resolution No. 47, by Holmes, is covered in the statement below:

While Government spending is not a part of taxation, it is directly related to it. In a republic governmental expenditures should be limited to those services necessary to protect the citizens from physical and economic aggression and to permit the citizens to provide themselves with economic, social, and cultural benefits not otherwise satisfactorily obtainable. Whenever an appropriation is proposed consideration should be given not only to the value of the services to be provided or objectives to be attained, but also, in addition, consideration should be given to the possible adverse effect of higher taxes upon the performance of the economy. Every possible effort should be made to gain economy and efficiency in government. A careful examination should be made of all departments of government in order to eliminate useless and unnecessary jobs and even projects. Agencies and bureaus created to provide services for which a need no longer exists should be abolished.

We endorse the recommendation of the national master that the various committees of Congress equip themselves with adequate staffs to make thorough and continuing independent studies of all the administrative departments of government. We recommend in addition that the selection of people for these staff positions be purely on the basis of merit and completely divorced from political patronage.

Because of the tremendous expenditures for national defense, we recommend that the National Grange urge representatives of our Government in the United Nations to direct their energies toward speedy adoption of a program of world-wide disarmament.

Outlays for foreign relief, reconstruction, and development should be held to a minimum, consistent with recovery and humanitarian considerations. Aid to any foreign country should be contingent upon that country's making a maximum effort to take care of her own people and to attain recovery as speedily as possible.

TAXATION GUIDELINES

We recommend the following guidelines for the National Grange tax policy:

1. Taxes should be based on ability to pay and benefits derived and should fall equally on person in like circumstances.
2. The tax system should impose the least possible restriction upon the expansion of production and employment and the launching of new enterprise, and should absorb as little as possible of the buying power of consumers.
3. Taxes should be adequate to meet the cost of government and to maintain confidence in the integrity of the dollar and the public debt.
4. Our debt-retirement policy (budgetary surpluses and deficits) should be coordinated with economic conditions to promote a stable price level, full employment, full production, and an expanding economy.

We make the following special recommendation regarding taxation

HIGHWAY FUNDS

Each State, by constitutional amendment or otherwise, should prevent diversion of highway funds to nonhighway purposes.

PERSONAL INCOME TAXES

1. Averaging of income and carrying forward of losses for a period up to 3 years should be allowed.
2. Personal income taxes should be maintained on a broad base.
3. To discourage corporation farming and large capitalists from acquiring large acreages of farm land, losses on agricultural operations should be deductible only from income derived from agricultural operation.
4. Quality in Federal income taxation should be established among those States which have community-property laws and those which do not.

ESTATE AND GIFT TAXES

1. because it appears that taxes imposed at death are less likely to have a depressing effect on incentive to enterprise and production and consumption than other taxes, increased revenues should be obtained from this source.
2. The use of trusts and gifts to escape taxation should be investigated and these avenues of escape closed.

EXCISE TAXES

It is resolved, That the National Grange go on record as opposed to any general sales tax, as putting an unfair burden on the costs of government upon the poor, and as supporting only sales tax on special articles of trade such as luxuries, liquor, tobacco, and other nonessentials; and we oppose the use of a graduated tax on cigarettes.

Whereas consideration is now being given to the revision of the Federal tax structure for the purpose of formulating a fair and equitable tax policy; and

Whereas the imposition of excise taxes on automotive and petroleum products by the Federal Government constitutes unfair and discriminatory taxation and imposes an unfair burden on motor-vehicle owners; and

Whereas these taxes were originally imposed in 1932 as temporary measures to provide revenues during the period of the depression and were continued and increased during World War II; and

Whereas the emergencies for which those taxes were imposed do not now actually exist and there remains no valid reason for their continued imposition; and

Whereas these taxes constitute an invasion of a field of taxation by the Federal Government which properly should be reserved to the States; therefore be it

Resolved, That when Congress moves to reduce taxes the National Grange

strongly urges the repeal of all Federal automotive excise taxes, including the Federal tax on automobiles, trucks, trailers, busses, automotive parts and accessories, tires and tubes, and gasoline and lubricating oils.

Whereas taxes are levied on the manufacture and sale of oleomargarine; and

Whereas producers and the consuming public have mutual interests in the manufacture and consumption of oleo: Therefore be it

Resolved, That the Washington office be requested to investigate the manufacture and sale of oleo and report to the next national session.

TAX REDUCTION

I. Whereas the following conditions exist in our Nation:

1. The national debt is at an all-time high, and prudence demands it be reduced when economic conditions permit;
2. Further inflationary price rises still threaten;
3. Needs for foreign relief and reconstruction may be great;
4. Full employment prevails; and
5. Personal income and national production are at peak levels: Therefore be it *Resolved*, That the National Grange recommend at this time that no reduction in Federal income taxes be made as long as the foregoing conditions prevail.

II. Whereas we recognize the following situation:

1. The time may come when reduction in taxes may be justified;
2. Taxes on the lower- and middle-income groups have a direct effect on the consumption of farm products;
3. A strong level of buying power by the lower- and middle-income groups is essential for any farm program based on abundance and a minimum of price regulation and support;
4. Many corporations and individuals are reporting profits which are excessive: Therefore be it

Resolved, That the National Grange urge that, when economic conditions warrant revision in taxation, it be in the direction of greatest reduction in the tax on lower- and middle-sized incomes. This can be done in two ways:

1. An increase in exemptions.
 2. A greater percentage reduction of the tax rate for the lower-income brackets such as is involved in a fixed point reduction in the tax rate at every level.
- We believe that every citizen should be conscious of the cost of government, and this condition is best realized when nearly every citizen pays some income tax. For this reason this committee recommends that, when income taxes are reduced, most of the reduction should come from a reduction in the tax rate of the lower- and middle-income levels rather than from an increase in the level of exemptions.

COORDINATION AND ADMINISTRATION OF TAXATION

Our whole tax system should be overhauled, and so far as possible duplications and overlapping of taxation should be eliminated. The taxing agencies of the various units of government should be consolidated as far as practicable. Every effort should be made to prevent tax evasion, and we favor adequate investigation to achieve this.

APPENDIX B

EXCERPT FROM ADDRESS OF ALBERT S. GOSS, MASTER, BEFORE THE EIGHTY-FIRST ANNUAL SESSION OF THE NATIONAL GRANGE, COLUMBUS, OHIO, NOVEMBER 12, 1947

TAXATION

It would be much more statesmanlike if those who are doing so much talking and making so many promises to cut income taxes would turn their energies to cutting expenditures and reducing our debt. Cutting income taxes has a strong political appeal among a limited group, but it would be far better to pay our debts while we are able to pay, and reduce the dangerous inflationary pressures we are under rather than to increase such pressures, as cutting taxes instead of our debts would surely do.

Cutting expenses is an altogether different matter. After 15 years of reckless expenditures, it is going to be difficult to reduce what appears to be a top-heavy governmental structure without impairing some activity which has become essential by reason of great changes brought about by war or other causes. Reductions in inflated Government pay rolls and unnecessary activities should have our strong support, but we should not talk about cutting taxes until savings in expenditures have actually been made and substantial sums applied on debt reduction. Wild statements that reduced tax rates would encourage such an expansion in industry that the additional income would actually increase tax receipts are not impressive in the light of the fact that business is more prosperous and making more money than ever before, and those who can get the location, the equipment, the material, and the labor are already going into business as fast as they can.

On the other hand, we must face the fact that most nonmilitary departments of the Government, which were compelled to expand tremendously because of war conditions, have made little or no progress in curtailing their activities, while some have unnecessarily enlarged them. Despite the fact that it is illegal for a Government employee to attempt to influence members of Congress on pending legislation, many bureau chiefs and employees have carried on well-organized campaigns to prevent putting any economies into effect and have gone unpunished, although the law provides specific penalties for the offense.

The Congress and the administration itself are faced with very real difficulties in trying to secure economical administration. Government operations are so vast that no one can know what is actually going on in more than a few departments, and must depend upon department heads and bureau chiefs for their information. It is only natural that these officials should be enthusiastic over the possibilities for service which lie within their jurisdiction, "if we only had the money." There is every urge for expansion, from the messenger to the bureau chief, and it is largely from this service that Congress must get its information.

I renew my previous recommendations that the various committees of Congress equip themselves with adequate staffs to make thorough and continuing independent studies of all the administrative departments of government. The members of the Congress should not have to devote days and days to detailed investigations which at best are mostly inadequate.

Neither should this responsibility be placed on the Comptroller's Office, which is an administrative unit itself. Its work should be to see that the accounting is adequate and accurate, but beyond this it has no business interfering with the operations of other departments or endeavoring to direct policy decisions with reference to them. Policy matters should be determined by the Congress in the light of its own investigation.

Economy would be served if corresponding committees of both Houses would maintain joint staffs for these studies. A few million dollars judiciously invested in this work would pay dividends of several thousand percent.

The attack on the tax status of cooperatives is a campaign largely waged by deception and misrepresentation. The cooperative method of doing business by joint employment of an agent to do the buying or selling for the members at cost has long been accepted as a legitimate and efficient method of operation. The patronage refund is the very heart of that method. Most of those attacking the cooperatives say they do not want to put them out of business and are not opposed to the patronage refund, but want to tax the "enormous" reserves which give the cooperatives such an advantage that they are driving other business out of the field. The president of the National Tax Equality Association, however, in his testimony before the House Small Business Committee, makes it clear that the real attack is on the cooperative method of doing business, saying: "The freedom of patronage refunds from tax liability is the main issue of the controversy." If cooperatives are enjoying special privileges by piling up unallocated reserves, I believe the law should be amended to give equal treatment to all. However, the facts are that the amount of such "evasion," if it exists, is so small as to be practically negligible. Taxing such reserves would not stop the hue and cry against cooperatives. The real motive is to tax patronage refunds out of business, and with them the whole cooperative system. We should resist this to the limit of our ability.

APPENDIX 0

TABLE 11.—Selected income series, 1910-40

Year	Gross income from agriculture I	from agriculture and other persons III	National income ²	Income of persons as a percentage of national income ¹	
				Gross	Net I
1910.....	Million \$7,352	\$4,450	Million 32,490	22.2	13.8
1911.....	7,081	4,333	32,490	21.81	12.0
1912.....	7,601	4,387	34,460	21.9	12.6
1913.....	7,827	4,387	37,762	20.77	11.6
1914.....	7,639.8	4,819.8		21.0	12.4
1915.....	7,968	4,208		20.8	11.6
1916.....	9,632		44,913	21.0	11.3
1917.....	13,147			24.6	13.0
1918.....	16,241		68,121	27.9	16.0
1919.....	17,710	9,877		26.8	14.9
1920.....	18,111		73,393.31	21.7	11.4
1921.....	19,478	3,795.5		18.0	6.6
1922.....	19,881.1	4,421	69,817.7	18.0	8.0
1923.....	15,907	5,689.1	70,634	13.1	7.9
1924.....	2,32.....		70,634	17.9M	7.91
1925.....	13,507.7	6,860	75,187	18.0	9.1
19.....	13,201		76,400	16.4	8.2
192.....	13,251.....	6,314	78,607	16.0	8.0
1929.....	13,551	6,687	81,044	16.7	7.3
1930.....	13,824	6,741		16.1	7.8
1931.....	11,1.....	5,114	75,364		8.8
1931.....	8,378		69,853	14.0	6.2
1932.....	6,4	2,283.1	43,905	14.7	7.1
1933.....	7,055	2,997	42,061.11	17.2	7.1
1934.....	7,480		49,448	17.2	7.1
1935.....	9,695		50,509	17.0	9.0
1936.....	10,641	5,311	55,707	16.2	8.2
1937.....	11,265			18.3	1.0
1938.....	10,071	6,041	60,412	15.2	7.6
1939.....	10,847		76,815.6	14.7	7.4
1940.....	11,011	8,301m	78,462	14.0	6.8
1942.....	13,894	7,721	5,261	14.6	8.1
1942.....	18,669	11,280	122,477	15.2	9.2
1943.....	23,031	14,138	181,758	15.2	9.3
1944.....	24,187	13,131		14.9	8.4
1945.....	25,432	13,711	163,170	15.6	8.4
1946.....	28,633	16,61	167,170 I	17.3	10.0

¹ Including Government payments, 1-13-46.

² Bureau of Agricultural Economics series.

source: Bureau of Agricultural Economics, Division of Statistical and Historical Research.

Mr. HALVORSON, I would like to say a little more on the matter of equity capital. Not only are the liquid assets of corporations high but even the assets of the higher income people is such that they hold a great volume of governmental bonds and other things like that, and that they could, if they were willing to venture, cash them in and get money that could be invested in stocks.

Secondly, we do recognize that equity capital is a serious problem. But we do not like to think—and I think it is sound—that the only way to keep our capitalistic economy going is to have a class of capitalistic plutocrats. We think if we are going to have a strong democracy we need a lot of capitalists. Therefore we think that every thought should be given to devising ways in which a small saver can invest in equity capital, or make equity investments.

For example, investment trusts is one method. It might be that insurance companies should be given authority to invest in common stocks. We know that over the long run, if they could just pull through the downs, they are going to get a higher return on equity investments.

This matter of steel capacity was mentioned. I do not know whether the failure of steel capacity to increase was a matter of not enough equity capital or the feeling that steel capacity is enough and that any further expansion would be simply unused capacity in a few years to come. That is the general explanation that I have had, that it is the unwillingness of steel to increase capacity because they feel that what plants they have under way will be enough.

Another point on this equity capital, I know that I have seen statements, in fact I believe it is in the President's economic report—how much weight you want to give to that—but I have also heard businessmen say that the postwar expansion of plant and equipment, in a number of cases, is nearing an end. I am not sure as to whether or not there is need for equity capital to continue so greatly in the future. Certainly it would be much better to spread it out over a number of years to help maintain a stable economy.

That concludes my testimony.

The CHAIRMAN. Senator George?

Senator GEORGE. No questions.

The CHAIRMAN. How would you assure spreading the venture capital out over a number of years?

Mr. HALVORSON. I think that if, as is argued, lower taxes would bring back greater capital expansions next year, one way to prevent it would be to keep taxes where they are. That would probably spread it out over a longer period. And then reduce taxes a little later on.

The CHAIRMAN. That is your thought as to the way to spread venture capital out?

Mr. HALVORSON. Into the future. Well, I am using the argument of the people who argue for tax reduction, in saying that reduction in taxes would encourage capital formation at this time. I would say, just following that same argument, let us leave the taxes where they are, and then as we reduce taxes in the future that would encourage capital formation.

The CHAIRMAN. Do you or do you not accept that theory?

Mr. HALVORSON. Yes, I do. I accept it.

The CHAIRMAN. It is a question of time, as far as you are concerned?

Mr. HALVORSON. Yes. It is a question of time.

The CHAIRMAN. How much time do you anticipate between the date of the tax reduction and its full effects on our economy? How much time do you figure elapses?

Mr. HALVORSON. As far as purchasing power, that I think is rather direct, because there are a lot of people now whose taxes are withheld and if reduced taxes go into effect tomorrow they would get more money in their pay checks this week, or in 2 weeks, or in a month or how they are paid.

In terms of capital formation I think it would be slower. It might probably take 6 months before the businessmen would feel that they could go ahead and feel more sure of a promising outlook for business.

The CHAIRMAN. As far as the relation of reduction to things other than immediate consumption of consumption goods is concerned, there definitely is a time lag, is there not?

Mr. HALVORSON. Yes, sir. I would say there is definitely a time lag between business deciding to go ahead and expand the plant from an impetus of lower taxes.

The CHAIRMAN. You cannot turn it off and on like a light switch, for example.

Mr. HALVORSON. No.

The CHAIRMAN. You cannot wait until the need is on you, and then pass a tax-reduction bill and expect the benefits to flow immediately.

Mr. HALVORSON. No. But on that point I do not think there is any indication that within 6 months or a year, or even a year and a half, that there will be an appreciable dropping off in capital formation. We think we could wait. Eventually we would favor a tax reduction.

The CHAIRMAN. In my personal opinion I think the evidence here makes it very clear that there is no private contribution to equity capital at the present time. So your theory necessarily bases itself on the proposition that the corporations have enough reserves to keep the thing going, and that it is desirable that they continue to finance themselves by incurring indebtedness rather than by equity operations.

Mr. HALVORSON. They do have a tremendous volume of liquid assets, and from year to year they build up funds for new capital through the depreciation reserves and retained earnings, and, of course, they can borrow, too.

The CHAIRMAN. The borrowing of money for plant expansion, whether by indebtedness financing or by raising equity money does not make any difference as far as inflation is concerned.

Mr. HALVORSON. Yes. Credit expansion is inflationary, but we say that if you want to fight inflation let us keep taxes where they are.

The CHAIRMAN. I understand that. If I borrow a thousand dollars to add a piece of capital equipment to my plant, I am going to market and buy that capital equipment. The effect on inflation is just exactly the same as if I issued a thousand dollars' worth of stock and spent the thousand dollars for the same purpose, is it not?

Mr. HALVORSON. If I saved the money in order to invest in capital stock, that kind of an investment is not as inflationary as if the businessman goes to the bank and borrows, which creates new money.

The CHAIRMAN. That creates new money?

Mr. HALVORSON. Yes.

The CHAIRMAN. So that is an inflationary process?

Mr. HALVORSON. Yes, sir.

The CHAIRMAN. And that is the way business is getting its money, is it not?

Mr. HALVORSON. To a considerable extent.

The CHAIRMAN. Where it is now providing out of its own reserves?

Mr. HALVORSON. Yes. It is inflationary. We agree with that and we agree with measures to prevent credit expansion as one way of fighting inflation and also maintaining present tax rates to fight inflation.

The CHAIRMAN. Has it come to your attention that the bankers of the country and the debtors of the bankers are already very much disturbed over the possibilities of credit contraction?

Mr. HALVORSON. I thought that a lot of them feel that credit contraction would be a good way of fighting inflation. I know that the housing fields, for example, they say that there is some shortage of money there, but that might be a good thing, a good way to get the prices of housing materials down, which are too high.

The CHAIRMAN. Maybe I misunderstood you. Do you believe that credit contraction is a method of fighting inflation or is it not?

Mr. HALVORSON. I believe it is a method of fighting it, yes. I believe that credit contraction is a way of fighting inflation.

The CHAIRMAN. Do you remember what happened in the 1920's as far as agriculture was concerned, as to unwise credit contraction?

Mr. HALVORSON. Yes. It was not only due to credit, however. I studied that. It was also due to the falling off in the export demand of farm products.

The CHAIRMAN. You know what the immediate result was as far as credit operations were concerned?

Mr. HALVORSON. The farmers could hardly get any credit. We have improved that considerably since that time with the Federal land banks, and other institutions.

The CHAIRMAN. But if you take out the credit ~~and~~ for these credit institutions they necessarily must contract the credit.

Mr. HALVORSON. I do not know how you would take out the credit base. The Federal Reserve System creates excess reserves by going into the security markets and buying Government securities or in some other way to increase excess reserves to the bank.

The CHAIRMAN. There are other ways of contracting the credit of banks. You can regulate their credit margins. Another is that you can take indebtedness, Government bonds, out of the Federal Reserve System.

Mr. HALVORSON. Yes. It is within the ~~scope~~ ^{power} of the Federal Reserve to increase excess reserves of member banks thus giving them more base to expand credit.

The CHAIRMAN. Do you believe that they can do that?

Mr. HALVORSON. Yes.

The CHAIRMAN. Assuming that they can, do you think they should?

Mr. HALVORSON. In the event of a depression or any indication of a downward spiral, I would say "Yes."

The CHAIRMAN. I suspect that we are talking of two different things.

Mr. HALVORSON. We have studied this considerably, the farm organizations. We have given considerable thought to it because of the importance ~~issues~~ members realize, of fiscal policy to national economic stability to their own welfare.

The CHAIRMAN. I may say that I have seen results of a poll taken among farmers by one of our Senators, which showed that the farmers in his State, assuming that the poll is representative, are 3 to 1 for tax reduction.

Mr. HALVORSON. We have a lot of farmers in our organization, over 800,000 of them, members, Grange members, and in our convention there was not a single bit of sentiment expressed on the floor for tax reduction.

The CHAIRMAN. Do you feel that you are competent to say right now how much debt retirement we should have every year?

Mr. HALVORSON. I would say that we should have as much as we can, without causing a deflation to such an extent that production and employment falls off.

The CHAIRMAN. Are you prepared to say, for example, that the Government could put its entire surplus of 1948, of seven and a half or eight billion dollars, into a debt retirement between now and the

end of the year, without severely contracting the credit base of the country?

Mr. HALVORSON. There would be some contraction. We think it would be a good thing, while inflation is our problem rather than deflation. At the appropriate time when indications are definite that prices were stabilized, or any indication of falling off in the demand of production or employment, that would be the time to come in with a tax reduction. In our testimony here we do favor a tax program which would go into effect, when and if conditions, as we indicate, would develop.

THE CHAIRMAN. I suggest to you that our fiscal experts in the Government are wondering right now as to whether they have not been retiring too much debt too rapidly.

Mr. HALVORSON. I did hear part of Secretary Harriman's testimony and he still felt that inflation was our major problem, if I understood his testimony right.

THE CHAIRMAN. As I understand it, among Treasury officials there is a definite feeling that perhaps greater caution should be used in the rate of retirement of public debt.

Mr. HALVORSON. That may be the Treasury's viewpoint.

THE CHAIRMAN. As far as your governmental expenditures are concerned, what is the difference, as far as inflation is concerned, between when the Government spends money and when the citizen spends it??

Mr. HALVORSON. I would say it might be more inflationary if the income goes to the Government to spend than if it goes to the citizen to spend. That is for Government expenditures I am talking about

Taxes that go to budgetary surplus are an entirely different thing than taxes that go into governmental expenditures as I pointed out in my testimony.

THE CHAIRMAN. Are you suggesting to the committee that we should maintain the present rate of taxes and apply all surplus to the reduction of debt?

Mr. HALVORSON. That is right. And we favor as much governmental economy as possible to make that surplus as big as possible.

THE CHAIRMAN. Would you take the debt out of the hands of the citizen, out of the hands of the bank, or out of the hands of the Federal Reserve System?

Mr. HALVORSON. I would take them particularly out of the hands of the commercial banks to reduce the volume of money. If there was an actual shortage of equity capital, as I have heard said, not only this morning but other places, it might be wise to pay off some of the bonds held by the people who might use it to good advantage for equity investment.

But as I have indicated before, I think it is more important to fight inflation than to get a lot of people bidding for scarce supply of this producers equipment.

THE CHAIRMAN. What happens when the Government takes a bond out of the portfolio of a bank?

Mr. HALVORSON. There is a reduction in the demand deposits.

THE CHAIRMAN. Does the Government pay for it?

Mr. HALVORSON. Yes. It pays for it out of taxes.

The CHAIRMAN. Does that not put that much money in the bank?

Mr. HALVORSON. What happens, if the Government taxes me \$100, it transfers that \$100 from my checking account to the Government's checking account, and the Government in turn says now we will call it even, write off a hundred-dollar bond that that bank has, and cancel the deposit that is credited to the United States Treasury.

The CHAIRMAN. But if the Government taxes John Doe \$100 and buys a hundred-dollar bond from Richard Roe, private citizen, what is the net effect?

Mr. HALVORSON. I did not get all that. I am sorry.

The CHAIRMAN. If the Government taxes John Doe \$100 by income taxes, and then the Government buys a bond from Richard Doe for \$100, thus it has retired \$100 of bonded indebtedness. But what is the net effect so far as inflation is concerned?

Mr. HALVORSON. If it pays off a bond held by an individual it would be a very slight effect on the inflationary situation. It would only mean that the first individual does not have the bond to insure his security, and he might be a little bit more careful about his expenditures. It would be very slight. It would be an effect on his rate of savings, individuals who were taxed, you might say.

But the fellow who got the bond might go out and increase his consumer expenditures, or he might go out and invest in equities.

The CHAIRMAN. By taxing John Doe you take a hundred dollars out of his pocket, and you have decreased his savings to that extent. When you buy from Richard Roe you increase his saving or spending capacity by \$100.

Mr. HALVORSON. That is right. You have converted his Government bond into cash.

The CHAIRMAN. Now, let us go to the bank. The Government buys a \$100 bond out of the portfolio of a bank. The bank gets \$100, and the Government gets the bond. Right?

Mr. HALVORSON. It amounts to a transaction where the \$100 deposit of the Treasury is just canceled against the bond on the asset side held by the bank.

The CHAIRMAN. The bank has \$100 in cash which it did not have before. Is that not right?

Mr. HALVORSON. No. It is simply a cancellation procedure. The bank has actually less deposits, demands deposits, after the transaction than it did before.

The CHAIRMAN. It has a \$100 bond in its portfolio to start with, in its investment portfolio.

Mr. HALVORSON. Yes. But in the first place you have to remember that you tax the individual who has a deposit in the bank by \$100, transferring that to the Government checking account, which is then just simply a cancellation across the board of the bond on the asset side of the bank, and the deposit side held by the Treasury on the other side in the bank ledger.

The CHAIRMAN. And the money that the bank receives for the bond is thus a base for additional credit, is it not?

Mr. HALVORSON. The bank does not really receive any money because it simply was a transfer in the first place from one of the depositors of the bank to the Government, and after the Government has it, it is simply a cancellation across the board. It is just a trans-

fer in the first place from an individual taxpayer to the Government.

The bank does not get any more money. It is just transferred from the taxpayer to the Government account, who cancels it across the board, the bond for the money held by the Treasury.

The CHAIRMAN. What happens when the Government takes a \$100 bond out of the Federal Reserve System?

Mr. HALVORSON. In that case it is about the same procedure that the Government Treasury account is reduced by \$100, and the Federal Reserve Bank has \$100 less on its asset side. Of course, that will be reflected in less bank reserves.

The CHAIRMAN. That is a credit construction.

Mr. HALVORSON. Yes.

The CHAIRMAN. So you would advocate following that procedure?

Mr. HALVORSON. Yes. That is right. There is a complication in that, that you might force the interest rate up on Government bonds, and that is why Eccles had his proposal for insulating the Government-bond market from the general interest rate.

The CHAIRMAN. You insist we are now in the position to use all the surplus for 1918 and all the surplus for 1919 for making debt reduction out of the Federal Reserve System?

Mr. HALVORSON. I would not say out of the Federal Reserve System. I would say that most of it would have to go retire the bonds held by the commercial banks.

The CHAIRMAN. Then under your own demonstration that would not effect the purpose that you have in mind.

Mr. HALVORSON. It reduces the volume of money. It reduces deposits, which is counterinflationary.

The CHAIRMAN. You have a statement:

It is a reduction of governmental expenditures rather than of taxes which will increase the supply of private goods and services available to our American consumers.

Is the total amount of goods purchased lessened or increased, when the Government reduces its expenditures?

Mr. HALVORSON. When the Government decreases its expenditures there is an expansion in private production because people formerly employed by the Government are then used for productive employment in private enterprise. Also because it reduces the purchases of the Government for materials, paper, or whatever else it is. It makes more of that available for private business and to the citizen.

The CHAIRMAN. The over-all amount, is that reduced? The over-all demands on paper, for example, would they be reduced by restoring to the citizens a greater amount of purchasing power?

Mr. HALVORSON. You are getting the purchasing power so that instead of the Government buying it you are leaving more money with the consumer or the business to buy that paper. That is as far as materials are concerned. As far as the labor is concerned, you are getting more people out of the Government to help produce paper, or whatever else it might be.

The CHAIRMAN. What is the net effect on the economy?

Mr. HALVORSON. It is an increase in the production of economy, if you cut down governmental expenditures, which is a different thing than cutting down taxes, which would be reflected in reduced budgetary surplus. That is another thing.

The **CHAIRMAN**. Your thought is that the Government as such does not set up these so-called productive enterprises, whereas, the citizen, if he is allowed to keep some of his money, will stretch it up?

Mr. HALVORSON. Generally that is it.

The **CHAIRMAN**. How do you reach a figure of 95 percent and 41 percent that you would favor a modest tax reduction in case employment should fall below 95 percent of the labor force? Why not 90 or 80?

Mr. HALVORSON. Ninety-five percent would mean about 3,000,000 unemployed. Even last summer, while prices were still rising, we had about 2.6 million unemployed. The more we feel that that indicates that 2.6 million unemployment would not necessarily reflect a deflationary tendency, probably due to shifts in employment from one business to another, and so on.

We feel that at 3,000,000 it means that some people are going to be out of work quite a while, but if it is not more than 3,000,000, a worker by looking around enough can find a job, and that is necessary to bring about adjustment from the contracting enterprises to expanding enterprises, we feel that 3,000,000 is about the figure.

The **CHAIRMAN**. You recognize the fact that a tax reduction does have a direct effect on employment?

Mr. HALVORSON. Yes, sir; certainly.

The **CHAIRMAN**. But if in our judgment we will be putting an anchor to windward, we ought to have the bill ready to go.

Mr. HALVORSON. That is right.

The **CHAIRMAN**. And in view of the lag between the effective date of the act and the effective effect of what we are doing, it might be entirely reasonable if we conclude it might be done now.

Mr. HALVORSON. I do not think there is any indication in the situation before us that we are facing deflation. I think there would be a rather prompt response to a cutting of taxes, particularly in consumer demand, because many people are on the withholding basis for taxation, if people at the end of this week would get \$5 more and go to the stores this week end and buy more things at the stores, that would mean that the factory would receive more orders, and they would hire people to produce more goods.

I think that as far as consumers' goods are concerned, the action would be rather prompt.

The **CHAIRMAN**. All expenditures made in the so-called consumer market are not inflationary.

Mr. HALVORSON. Expenditures in the consumer markets?

The **CHAIRMAN**. Do not all bear on short-supply markets, do they?

Mr. HALVORSON. No. But generally, as far as the price level is concerned, they do have a general effect on the price level.

The **CHAIRMAN**. They might affect meat?

Mr. HALVORSON. That is right.

The **CHAIRMAN**. They might affect grain?

Mr. HALVORSON. Yes, sir.

But if all prices would fall together, I think farmers would be very happy. They would not like to see their prices fall and none of the others. But, generally, I think that everybody realizes that their savings would go a lot further, and would have a more-lasting effect upon the markets and prosperity of this country, if prices were lower, so that their savings would buy more, would keep production rolling

